Nos. 226, 227, 243, 266.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 226.

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

CENTRAL-ILLINOIS SECURITIES CORPORATION, C. A. JOHNSON, LUCILLE WHITE and FRANCES BOEHM.

No. 227.

THOMAS W. STREETER, *et al.*,
Petitioners,

v.

CENTRAL-ILLINOIS SECURITIES CORPORATION, C. A. JOHNSON, LUCILLE WHITE and FRANCES BOEHM.

No. 243.

THE HOME INSURANCE COMPANY and TRADESMENS NATIONAL BANK AND TRUST COMPANY,
Petitioners,

v.

CENTRAL-ILLINOIS SECURITIES CORPORATION, C. A. JOHNSON, LUCILLE WHITE and FRANCES BOEHM.

No. 266.

CENTRAL-ILLINOIS SECURITIES CORPORATION and CHRISTIAN A. JOHNSON,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION, THOMAS W. STREETER, *et al.*, HOME INSURANCE COMPANY, *et al.*

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

ANSWERING BRIEF OF THOMAS W. STREETER, *ET AL.* TO BRIEF OF CENTRAL-ILLINOIS SECURITIES CORP., *ET AL.*

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ANSWERING BRIEF OF THOMAS W. STREETER, *ET AL.* TO BRIEF OF CENTRAL-ILLINOIS SECURITIES CORP., *ET AL.*

Preliminary.

The Brief previously submitted on behalf of Thomas W. Streeter, *et al.*, contains the following subjects— Opinions Below, Jurisdiction, Statute Involved, Questions Presented and Statement, to which the attention of this Court is respectfully directed and which it is

requested, be deemed incorporated herein. This Brief[1] will be devoted to answering the contentions raised in the Brief of Central-Illinois Securities Corporation and Christian A. Johnson, Respondents-Petitioners.[2]

The Procedure Suggested by Central-Illinois and Its Implications.

At the outset it should be noted that this case involves much more than the cash in the escrow fund. The issues lie far deeper than that. If the technique proposed by Central-Illinois is followed, the following will be the pattern in future cases:

First, if this Court upholds the District Court, it will amount to a judicial approval of by-passing the Commission in matters involving simplification under the Act, and particularly in valuation problems.

Second, it will place a premium on small groups of minority stockholders (a) offering no evidence before the Commission, (b) offering no evidence before the District Court, and (c) using arguments in briefs based on matters not in the record relating to alleged facts happening either prior to or subsequent to the Commission proceedings and even *after* consummation of the plan. It will place a premium on objecting stockholders carefully avoiding any request for a hearing or a reopening, at the same time implying radically changed circumstances. It will open the door to objectants having no connection with the

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[1] The Brief, previously submitted on behalf of Thomas W. Streeter, *et al.*, will be called hereinafter the "Streeter Brief".

[2] The Brief for Central-Illinois Securities Corp., *et al.*, will be called hereinafter the "Central-Illinois Brief". For the sake of brevity, we shall also hereinafter refer to the Respondents-Petitioners as "Central-Illinois". In answering the contentions raised, we have followed the sequence of the Central-Illinois Brief.

Company to persuade district courts after "extensive oral argument and briefs" (see Central-Illinois Brief, p. 15) to decide valuation questions on the basis of "colloquial" equities.

Finally, it will approve a procedure eliminating a remand so that experts of the Commission and other litigants who have participated in this proceeding from its inception, would have no opportunity to expose the inapplicability of the mass of irrelevant financial data, of which this Court and the lower courts have been asked to take judicial notice.

This is the program that will stem from an affirmance of the District Court's order as requested by Central-Illinois.

Fair Presentation of the Record.

1. Haphazard Market Prices v. Fair Investment Value.

The brief of Central-Illinois exhibits a penchant for the selection of a single element, out of many considered by the Commission coupled with the incorrect assertion that such single element was the *only* element which the Commission considered. Having adopted this baseless premise, the brief proceeds to build legal arguments on such an unsubstantial base. Thus, the statement is made and frequently reiterated, that the Commission determined the investment values of the preferred and the equitable equivalents of the rights which the preferreds were forced to surrender "solely on the basis of market prices of allegedly comparable preferred stocks, as of a specific haphazard moment".[3] This demonstrably

[3] Central-Illinois Brief, pp. 26, 72 ff.

false statement is repeated in many ways and forms and many arguments are predicated on this incorrect representation of the record. In answer, we prefer to let the following portion of the record speak for itself (R. 1173a-1176a):

"Q. Dr. Badger, page 4 of your report, second full paragraph, your definition of fair investment value, reading:

'Fair investment value may be defined as the price or value at which the shares of the several classes of stock would exchange hands between willing buyers and willing sellers, neither under compulsion to buy or to sell, and both thoroughly informed of all of the various elements of value.'

Could you tell me what you had in mind when you used as part of your definition 'all of the various elements of values'?

A. Well, the elements of value would include a question of the history of the enterprise, the question of its management, the nature of the business in which it was engaged, the question of competition, the question of past, present and future earnings, the dividend-paying capacity of the Company, the asset values behind the security—that, I think, would cover the more important elements.[4]

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[4] The following statement from *Matter of Fulton*, 257 N. Y. 487, 495 (1931) supports Dr. Badger's concept of value:

"It will be readily appreciated that the appraisers should have considered the investment value of the stock which is largely determined by the rate of return, the security afforded that the dividends will be regularly paid, the possibility that dividends will be increased or diminished, the selling price of stocks of like character, the amount of preferred stock in comparison with the common stock, the size of the accumulated surplus applicable to the payment of dividends, the record of the corporation and its prospects for the future."

Q. And in your determination of the fair investment value of the preferred stocks of Engineers did you take into consideration every one of those elements of value?

A. Yes sir. I did not cover them all in this report, but I gave consideration to all of them.

* * * *

Q. In other words, your over-all judgment figures which you set forth in the conclusions did consider in one form or another all these elements of value?

A. That is correct.

Q. You speak on page 4 under the title 'Basis of Valuation,' "Although the several classes of preferred stock of Engineers Public Service are bought and sold on the New York Stock Exchange, the reported prices at the present time cannot be regarded as representative of fair value.'

Now, my question is: Can market value ever be regarded as representative of fair value or fair investment value, as you put it?

A. Well, that is a rather difficult question to answer. I think it would be a fair statement to say that in a free and unfettered market that on any given date the market prices as emanating from purchase and sales might or might not be the fair value, but that they tended to approach it, and stocks that are actively traded probably approach fair investment value very closely, unless by virtue of pronouncements by the management of the company, unless by virtue of circumstances that create either fear on the one hand or a favorable atmosphere on the other hand, through events that may or may not be permanent and as the result of those events unduly depress or unduly raise the price of stock, that in the case of actively traded stocks we frequently

have a close approach to fair investment value represented in the market prices of stocks.

Q. Using your expression 'Free and unfettered market' in your experience as an expert financial analyst have you ever noticed any stock or any time when the stock market was ever in a condition that you could say it was free and unfettered?

A. Well, I think it more closely approaches it at certain times than it does at other times. For example, in the period between 1929, and I might extend that period well into the '30s, we had a serious depression involving heavy liquidation of borrowings, which had been made by individuals to carry securities, and unquestionably market prices at that time were depressed, possibly very substantially below their true investment values because of necessitous liquidation. It is my opinion that for a considerable period time, and as the result of adverse political developments in respect to public utility stocks, that certain public utility stocks were selling below their fair investment value. There may be other periods, such for example as the present time, when a stock like this newly launched automobile firm, may be selling at above its fair investment value. That, of course, is a question that will take time to answer, but, on the other hand, stocks that are very actively traded, without any undue influences prevailing in a given time, presumably closely approximate their fair investment value.

That is about the only answer that I could give to that question.

Q. *But you would not, in your opinion, as an expert, substitute market values as a test to determine fair investment value in and of itself?*

A. *No, sir.*

Q. And would you say that preferred stocks similar to those of Engineers Public Service Company, or any preferred stock of a holding company which is under the jurisdiction of the Holding Company Act, has a free and unfettered market?

A. Well, I would say that many of them do not have a free and unfettered market.

Q. And with specific reference to the Engineers preferred stock?

A. That is true. I do not believe that that stock at the present time is enjoying a free and unfettered market and I think it is influenced, as I have stated, by the proposal of the company, and the threat of litigation in connection therewith, to pay off such stock at $100 a share." (Italics ours.)

Further evidence bearing on the question of investment value and substantiating the fact that the Commission did not restrict itself to valuing the preferred by reference to the single element of temporary market prices at a "haphazard moment", appears in the opinion of counsel for Engineers, in which he recommended the amendment of the plan to conform with the Commission's views, *i. e.*, to provide for the payment of the call prices to the three series of preferred stocks, and stated as follows:

"* * * the above mentioned finding that the investment value of the preferred stock apart from the Act is equivalent to the respective redemption prices is clear cut and finds substantial evidence in the record. Furthermore it is a fact which Engineers admitted at the hearing, in its brief and on the argument. It appears clear, there-

fore, that that fact finding must be accepted without question (R. 1953a)."[5]

2. Quality Ratings of Independent Analysts v. Expert Testimony.

Another example of the failure of Central-Illinois to give the Court a reasonably fair impression of the record relates to the references to Standard & Poor's "rating" of Engineers preferred stock of "C**".[6] Every effort is made to have this Court conclude that the Commission was misled or misguided in its finding the fair investment value equal to the respective call prices of the preferreds, because of this rating. On this score the interrogation of Dr. Badger by Engineers counsel as set forth below is very enlightening:

"Q. What is the difference, Doctor, between a current investment rating and a current market rating? One for the short pull and the other for the long pull?

A. No, sir; I believe that Standard Statistics

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[5] Compare this admission of counsel for Engineers with the following statement of the District Court:

"It is, of course, true that once the charter is not accepted as controlling, there is no reason why 100 is the necessary figure for a senior security holder to receive. It may be more or it may be less. But in this case, after consideration of all factors involved, I conclude that $100 would be fair and equitable (R. 288a, n. 2)."

Having concluded that the charter did not control the District Court's finding of $100 as the *value* of the stock had no foundation in the record whatsoever.

[6] Central-Illinois, Brief pp. 12-13 wherein it refers to the analysis of Engineers preferred rating of "C**", defined as follows:

"'Preferred stocks with erratic dividend records which can be expected to make payments only under favorable conditions' (R. 1844a-1845a)."

found their method of investment ratings as applied to preferred stocks to be of little or no value and I believe for that reason they discontinued them.

They substituted in lieu thereof a series of ratings that could be maintained more up-to-date, that were more current, and were used to reflect those factors that give rise to, we will say, value determining factors, in respect to the several preferred stocks.

Q. Are you through?

A. Yes, sir.

Q. Now, Doctor, what do you base that belief on? You said you believe something. Were you informed by some official of Standard & Poors that that was the reason that they discontinued the ratings?

A. Yes, sir; I was.

Q. Who gave you that information specifically?

A. That information was contained in a bulletin that was put out by the Home Office of Standard Statistics and was supplied to all of their sub-offices, and I was furnished a copy of that bulletin from the Detroit office and I have the bulletin right here, as a matter of fact.

Q. Will you let me see the bulletin?

A. Yes, sir (R. 1124a-1125a)."

The document produced by Dr. Badger is preferred stockholders' Exhibit No. 35, R. 2120a, 2121a. It is dated April 25, 1945, almost nine months *before* Dr. Badger testified. The authors of the rating had this to say about their own estimate concerning the reliability of the preferred stock ratings:

"PREFERRED STOCKS, ALSO QUALITY RATINGS ON PREFERREDS.

"*We have wanted to drop preferred stock*

quality ratings for years. A quality rating on a preferred doesn't mean very much, as in the case of a bond, for the simple reason that the two are entirely different types of investments.

"We had an A rating on National Lead preferred while it fluctuated all the way between 60 and 170. That doesn't make sense. A *market* rating there was of highest importance. But for anybody foolish enough to disregard market prospects, the one important thing was dividend coverage. Well, the dividend was adequately covered during that tremendous fluctuation. And in a variable security, with no maturity date, that's the only quality feature that matters, while market performance and prospects are often of highest importance.

"That paragraph explains why we moved preferreds over into the Stock Guide where they belonged, and where we cover over 1,000 issues, and cover them properly and why we abandoned meaningless quality ratings to induce investors to use safer tests with more meaning in judging the investment quality of preferreds." (Italics ours.)

In the same vein is the following excerpt from the cross examination of Dr. Badger:

"Q. Well, Doctor, they say they stopped the stock rating, even high grade preferred stocks, because they fluctuated all over the map, didn't they, in effect?

A. They said that they ceased assigning investment quality ratings to preferred stocks because of the fact that their quality ratings were meaningless (R. 1134a)."

Thus it appears that the Central-Illinois reference to the so-called "quality rating" by an independent

analyst of "C**" to the Engineers preferred was misleading and did not establish error on the part of either Dr. Badger or the Commission. Although we recognize as has the Commission[7] that the reports of analysts, not subject to cross examination are not evidence *per se*, since counsel have attempted to disparage Dr. Badger's testimony by reference to such a report, we desire to call the Court's attention to the values placed on the three subsidiaries of Engineers by statistical houses of generally good repute. They illustrate the conservatism of Dr. Badger's conclusions. Set forth below is a list of these firms and their respective estimates which were introduced in evidence.[8]

Firm	Virginia	Gulf States	El Paso	Total
Ira Haupt & Co.	$70,600,000	$25,000,000	$ 6,000,000	$101,600,000
Carl M. Loeb, Rhoades & Co.	71,247,000	31,712,000	8,655,000	90,400,000
Bear Stearns & Co.	68,000,000	30,000,000	10,000,000	108,000,000
Duff and Phelps	80,000,000	35,000,000	10,000,000	125,000,000
Security Supervisors	70,000,000	30,000,000	9,000,000	109,000,000
Paine, Webber, Jackson & Curtis	83,000,000	44,000,000	8,000,000	135,000,000
AVERAGE	$73,608,000	$32,619,000	$ 8,609,000	$111,500,000
Per Share of Engineers Preferred				$284
Badger's Estimate[9]				$265

[7] *Engineers Public Service Co.*, 9 S. E. C. 84, 90 (1941).

[8] Pref. Exhs. 26-A–26-I, R. 1980a-2045a. These analyses were not offered as proof of the facts, but for the limited purpose of showing estimates of independent analysts. The management considered several of these reports in devising the plan. R. 945a, R. 1006a, R. 1007a.

[9] Pref. Exh. 29-A, R. 2106a.

3. Offer of Proof v. Actual Introduction of Evidence.

Another inaccuracy in the Central-Illinois Brief relates to the Puget Sound matter: The following assertion is made in the Central-Illinois Brief:

> "The District Court's findings as to the losses were based upon *uncontradicted evidence* that Engineers would have been able to obtain much higher prices if it had not been compelled to carry out the divestments, or alternatively would have received higher earnings if it had retained the assets (cf. Finding 37, R. 307a-308a)" (p. 61, n. 1). (Italics ours.)

Examination of Finding No. 37 discloses *inter alia*, the following statement:

> "* * * A formal offer of proof was made during the proceedings before the Court to establish that the equity owned by Engineers in Puget Sound prior to the recapitalization would presently have a cash value of $10,000,000 (R. 307a)."

The nature of the "offer"[10] is extremely interesting. No reference thereto appears in the record of the hearing before the District Court although that statement of "offer" is contained in the findings prepared for the District Court by Central-Illinois counsel. The

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[10] It is well settled that enforcement proceedings are heard only on the administrative record and that the District Court cannot receive evidence not presented to the Commission. Streeter Brief, p. 73, n. 97. Counsel for White significantly recognizes this principle when he stated in his argument before the District Court as follows: "We are practically willing and we are prepared, if your Honor will give us the opportunity, to present testimony to the *Commission* of what the real investment value of this stock is" (R. 220a-221a). (Italics ours.) Contrast this admission with the so-called "offer of proof" in the District Court Brief of Central-Illinois.

only basis for the statement appears to be a footnote in the Central-Illinois Brief submitted to the District Court reading in part as follows:

> "Expert testimony *can be made available* to the Court that the Puget Sound common stock owned by Engineers would today have a value of approximately $10,000,000 based on conservative capitalization of earnings" (Brief dated February 11, 1947, p. 8, n. 12). (Italics ours.)

Apparently such was the nature of the offer of proof to establish the present cash value of Engineers equity in Puget Sound at $10,000,000 which would support the claim of loss. As a substitute therefor judicial notice of certain statistics was written into the findings by Central-Illinois counsel.[11]

4. 20-30% of Total Capitalization v. Virtual Ownership and Control.

The examples of failure to correctly present the state of the record could be multiplied. Thus although it is not denied that the common stockholders of Engineers received virtually all of the stock of the three underlying operating companies and had virtually complete control thereof, expressions are used that the common stock of these companies represent only 20-30% of the *capitalization*.[12] The implication from the Central-Illinois statement is that the Engineers common stockholders did not control the three underlying

[11] It should be noted in this connection that Rule 52(b) of the Federal Rules of Civil Procedure indicates that findings of fact in non-jury actions may be questioned as to the sufficiency of the evidence to support them regardless of whether or not an objection or a motion to amend has been made.

[12] Central-Illinois Brief, p. 7, n. 3; p. 39, n. 1.

subsidiaries after the preferred were ousted. This is, of course, inaccurate. It is also clear that a primary objective of the plan had been to eliminate the preferred from the enterprise in a manner permitting the common stockholders to obtain direct and complete ownership of the three subsidiaries. The testimony of the company's secretary demonstrates this truth (R. 819a). This objective is clearly established by the following testimony of the Company's secretary:

> "Q. Didn't you say that the record of activities on the part of the management of Engineers suggests a rather persistent effort during the last four years to get rid of the preferred stock in this situation?
>
> A. Yes (R. 733a)."

5. "Special Assessment" v. Bargain Purchase.

Central-Illinois also attempts to convey the impression that the Gulf States warrant program was in effect a "special assessment" on the common stockholders.[13] This is, of course, entirely untrue.[14] The common stockholders were under no obligation to exercise the warrants and had the privilege of selling them. In fact, the preferred stockholders vigorously opposed the proposal to issue the warrants to the common on the ground that it discriminated against them because they were excluded from the program. Moreover, the issuance of the warrants was a method chosen by the management to raise additional

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[13] Central-Illinois Brief, *i. e.*, p. 9, n. 1; p. 18; p. 60; p. 102.

[14] Central-Illinois was successful in confusing the District Court regarding the true nature of the warrant. See finding 12 (R. 297a) and finding 40 (R. 309a) where the Court refers to the program as a "sale" or "contribution".

cash needed to retire the preferred stock in Engineers which had a prior claim on the Gulf States stock. In offering the common a chance to buy Gulf States stock at $11.50 per share the company was, in effect, declaring a property dividend to the common stockholders since the stock was worth considerably more than the market price (R. 748a).[15]

To be contrasted with the characterization of "special assessment" is the following statement:

> "A bargain purchase offered to stockholders by the corporation may be tantamount to a partial property dividend. * * * Similar cases are likely to arise where a corporation under legislation such as the Public Utility Holding Company Act, * * * finds it desirable to distribute a large block of assets to stockholders, but only if it is able partially to recoup its asset position by requiring stockholders to make a partial payment for the assets. In such bargain purchases, the difference between the price paid and the value of the assets received constitutes, of course, a dividend to stockholders * * *" (Kehl, *Corporate Dividends* (1941), p. 171).

6. Time Limit on Compliance.

Central-Illinois has asserted that the provisions of section 11(c) of the Act constituted a period of limitation which forced prompt action by the Company in complying with divestment orders of the Commission. It is clear, however, that section 11(c) is *not self-enforcing* and there is but one instance of its use and that was, in effect, at the request of the particular com-

[15] The Company's secretary testified, in effect, that these warrants were worth $4 to $5 each (R. 748a).

pany. The rarity of the use of section 11(c) is attested to by Mr. Milton Cohen, former Director of the Public Utilities Division, when in connection with a proposed amendment to section 11(c), he stated at a Congressional Hearing as follows:

> "The court, as I also said the other day, in answer to Mr. Winter's inquiry, would still not do anything in the way of enforcement under this statute, and the statute, as far as this section is concerned, *is not self-enforcing except* upon application by the Commission even after the expiration of the second-year period, and *such application for enforcement of a Commission's order has, up to the present time, never been made to a court for enforcement of one of these orders except in a single instance where the company, in effect, asked for such procedure in order to protect its maturities."* (Hearings before the Securities Subcommittee of the House Committee on Interstate and Foreign Commerce, 79th Cong., 2nd Sess., p. 1091.) (Italics ours.)

In so far as Engineers itself is concerned, the complete answer to this innuendo of the element of "pressure of time" is seen from the fact that the Engineers proceedings were started in 1937 and in the entire record of *ten* years following, no order to liquidate was ever entered against Engineers.

7. Destruction of Values v. Preservation.

There is another contention made by Central-Illinois throughout its brief not borne out by the record that the common stockholders bore the brunt of the simplification of the Engineers system, and that the

liquidation resulted in the *aggrandizement* of the preferred, at the expense of the common.[16]

A long line of alleged hardships, sacrifices, and detriments flowing from the simplification of the Engineers system, is asserted to create equities for the common as against the preferred. The record indicates to the contrary.

It will not be disputed that the actual method of divestment was entirely a choice of the common stock management. The portfolio securities could have been used in exchange to retire the preferred had the Company not been pursuing a policy of getting rid of the preferred stock at a discount, by cash payments.[17]

Central-Illinois would have this Court believe that the enterprise was "whittled down", at great loss to Engineers in assets and earnings, because of the Commission's various divestment orders. Actually what happened was that Engineers pruned its system of dead wood and a few live twigs, at no net loss to the system but with the consequent tripling of earnings available to the stockholders, on a consolidated basis.

Subsequent to registering under the Act, Engineers took the following action with respect to its minor subsidiaries:

In October, 1941, The Western Public Service Company sold some property in Las Animas, Colorado to the city. In 1942, Engineers sold the common stock of Western to a public power district after having

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[16] Central-Illinois Brief, pp. 18, 23, 60 and 116.

[17] In 1943 Engineers actually made an offer to the preferred stockholders to exchange a maximum of 25,678 shares of their stock for shares of El Paso Natural Gas Company plus cash. The plan failed because the aggregate amount offered in exchange totalled less than $100 per share whereas the market price of the preferred was in excess of that amount. H. C. A. R. Nos. 4421 (1943) and 4559 (1943).

first acquired the Wyoming properties and ownership of the subsidiaries of Western which owned properties in Missouri and North Kansas. A new subsidiary, The Western Public Service Company (Delaware) was formed to own and operate the Wyoming properties. The net proceeds were about $3,070,000 representing a loss of $1,124,000.[18] The Missouri properties were sold in 1945 at a loss of about $244,119.[19] The Western Public Service Company (Delaware) was sold in 1946 at a loss of $342,000.[20]

Baton Rouge Electric Co., Louisiana Steam Generating Corporation and Gulf States were consolidated in 1938. The bus properties were transferred to Baton Rouge Bus Co. Inc. and the bus company was sold later at a profit of $180,801.[21]

In 1943, Engineers sold its holdings in The Key West Electric Company at a profit of $386,528.[22] The transportation and bridge properties of El Paso were sold in 1943 at cost.[23]

In 1945, Engineers sold its holdings in Savannah Electric & Power Company at a profit of $221,535[24] and in March, 1944, the balance of the investment in El Paso Natural Gas Co. was sold at a profit of $1,095,325.[25]

In 1936 and 1937 after passage of the Act but before Engineers registered with the Commission, the Company had sold two blocks of stock in El Paso Natural Gas Company at an aggregate profit of $1,440,303.[26]

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[18] Engineers Exh. 37-I, R. 1575a.

[19] Engineers Exh. 37-L, R. 1625a, 1626a.

[20] 1946 Annual Report, Engineers Public Service Co., S. E. C. Form U5S, 1946.

[21] Engineers Exhs. 37-F, R. 1520a; 37-K, R. 1609a.

[22] Engineers Exh. 37-K, R. 1608a.

[23] Engineers Exh. 37-K, R. 1609a.

[24] Engineers Exh. 37-L, R. 1625a.

[25] Engineers Exh. 37-K, R. 1610a.

[26] Engineers Exh. 37-E, R. 1504a.

The net result asset-wise from these divestments was a profit to Engineers in the sum of $1,614,373.

Of the major subsidiaries in the Engineers' system all but Puget Sound Power & Light Co. were still part of the system when Engineers was dissolved and its holdings distributed to its own common stockholders pursuant to the plan. Puget had been a cancer in the system from the time of its acquisition in 1928.[27] It consistently failed to earn its own preferred dividend requirements and in 1938, Engineers voluntarily created a reserve to reflect the "depreciation" in this and other "investments", in the sum of $35,000, and embodying a "substantial allowance" for Puget Sound. In 1943, Puget was recapitalized[28] and by virtue of the application of the investment value theory, Engineers received 3% of the new common stock in the reorganized company. These securities were sold in 1944 for $777,475, resulting in a book loss to Engineers of $33,320,519.[29]

Even after the so-called "whittling" of the system the fact remains that the Company's assets as of June 30, 1945 aggregated $65,756,904 (R. 86a) as compared with assets in 1938 of only $60,909,703[30] before the

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[27] Engineers Exh. 37-P, R. 1663a.

[28] *Puget Sound Power & Light Co.*, 13 S. E. C. 226 (1943).

[29] Engineers Exh. 37-K, R. 1608a. In this 1944 Engineers Annual Report to Stockholders, appears the following significant statement:

> "* * * The total loss was therefore $33,320,519, of which $29,297,000 was charged against the reserve created in 1938 for depreciation in the value of this investment, $75,358 was charged against earned surplus in December 1943, representing the loss on 1,200 shares sold in that month and $3,948,161 is provided for by a reserve set up in December 1943 through a charge to earned surplus to provide for the loss to be realized through the sale of the remaining investment in February 1944. *Based on the rates in the Revenue Act of 1943, enacted February 25, 1944, it is estimated that the annual saving in consolidated Federal income and excess profits taxes, by reason of the divestment of Puget Sound Power & Light Company, will amount to approximately $442,000.*" (Italics ours.)

[30] Engineers Exh. 37-E, R. 1525a.

pruning began. Thus asset-wise, the appellees are woefully in error when they claim the enterprise has shrunk.

Moreover, on an earnings basis, the record is clear that the elimination of the various properties was, on the whole, of great benefit to the stockholders. The table set forth below[31] shows that the earnings of subsidiaries applicable to common stock owned by Engineers (and now owned directly by Engineers' common stockholders) more than doubled after the

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[31] EARNINGS OF SUBSIDIARIES APPLICABLE TO COMMON STOCK OWNED BY ENGINEERS FOR YEARS ENDED 1937, 1945 AND 1946

	Name of subsidiary	Amount a 1937	b 1945	c 1946
f.	Baton Rouge Electric Co.	$ 249,436		
f.	Eastern Texas Electric Co.	882,260		
f.	Louisiana Steam Generating Co.	397,465		
f.	Gulf States Utilities Co.		$1,883,033	$2,400,000
g.	El Paso Electric Co. (Delaware)	163,020		
	El Paso Electric Co. (Texas)		525,600	633,400
h.	Savannah Electric & Power Co.	144,482		
i.	Virginia Electric and Power Co.	2,215,156	4,014,293	4,666,879
h.	The Key West Electric Co.	1,575 d		
j.	Puget Sound Power & Light Co.	359,875 d		
	TOTAL	$3,690,370	$6,422,926 e	$7,700,279 e

a. From Eng. Exh. 37E, R. 1513a.
b. From Eng. Exh. 63, R. 1828a. Assumes disposition of The Western Public Service Co. in 1945.
c. From Eng. Exh. 63, R. 1829a, showing estimated earnings.
d. Red figures.
e. Does not give effect to reduction in Federal Income and Excess Profits taxes resulting from extraordinary non-recurring deduction items.
f. Consolidated as Gulf States Utilities Co.
g. Dissolved.
h. Sold.
i. Merged with Virginia Public Service Co.
j. Reorganized and Engineers' interest sold.

program of divestment was completed. And as further proof of the fallacious argument of Central-Illinois, that divestments caused a whittling down of the system in any substantive manner, it appears from its own statements that for the twelve months ended June 30, 1947 the three remaining subsidiaries reported earnings of $10,629,724.[32] In decided contrast, at the time of the enactment of the Act the balance of earnings applicable to Engineers' holdings in all its 17 subsidiaries was only $1,605,867.[33]

8. Idle Cash v. Capital Appreciation and Increased Equity:

The Central-Illinois attempt to show that the common stockholders had been altruistic in leaving cash in the enterprise,[34] is likewise not supported.[35] It is made to appear that the common stockholders were compelled to do what they did by virtue of the provisions of the Act. The record clearly establishes that the cash was accumulated designedly by the small group of controlling common stockholders of Engineers, in order to avoid high federal personal income taxes and provide the means for getting rid of the preferred stockholders. The withholding of dividends on the common stock was a matter dictated by the self-interest of the common stockholders. Rather did they prefer to make capital gains and also build up their equity. It is barely possible that the common might have been virtually excluded from the enterprise instead of the preferred, if the common had elected to receive income available to them, over the years. The circumstance that the preferreds were likewise helped does not necessarily support a claim of hardship on the common. The contention that divi-

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[32] Central-Illinois Brief, p. 101, n. 2.
[33] Engineers Exh. 37-C, R. 1473a.
[34] Central-Illinois Brief, p. 15, n. 1.
[35] Streeter Brief, pp. 119-120.

dends were withheld from the common stockholders so as to provide for the company's liquidation is therefore a complete distortion. On the contrary, a deliberate policy of cash accumulation had been pursued so that the preferred stockholders could be bought out piecemeal and at a discount. In this way the common stockholders received capital appreciation instead of taxable dividends. There was no need to withhold dividends to retire the preferred. Liquidating dividends in kind could have been paid to both preferred and common.

Furthermore, it appears that Gulf States had paid common stock dividends of approximately 50% of the balance available for common stock, from 1939 to June, 1945 (R. 36a). It further appears that the Engineers common had already received the benefit of retiring some 37,560 shares of preferred stock at substantial discounts (R. 39a) and that Gulf States could have been sold through competitive bidding, to yield at least $30,000,000 (R. 53a). Yet Engineers management was contented to let the common stockholders acquire this asset for approximately $22,000,000. The Engineers preferred had provided valuable leverage for the common and in 1945, with three prosperous operating companies in splendid condition, producing large income, the common no longer wished to tolerate the preferred in the enterprise. Engineers had accumulated large amounts of idle cash from previous property dispositions and retained earnings. As was pointed out by the Commission: "Ordinarily a company in this position would exercise its call privilege and redeem the preferred at its call price. However, Engineers has proposed to dissolve by paying off the preferred in cash and distributing the remaining assets to its common stockholders" (R. 60a).

Another advantage to the common (R. 70a) with respect to the Gulf States common stock as reclassified, is clear from the following comment by the Commission (R. 70a-71a):

"* * * At $14 per share a dividend of $.80 would provide a yield of 5.72%, and on an earnings basis of $1.31 a share, the times earnings ratio would be 10.7 * * *

"On the basis of earnings available for common stock for the 12 months ended June 30, 1945, the following effect on a share of Engineers' common stock will take place upon operation of the plan, assuming the bank loan were deleted and the warrant price increased to $14 per share:

TABLE XII

Per share of common stock	
Earnings on a consolidated basis	$ 3.16
Earnings on a consolidated pro forma basis	2.57
Decrease in Engineers' earnings	$0.59
Earnings on 1/5 share of El Paso	0.32
Net decrease in earnings	$0.27
Earnings per share of Gulf States	1.31
Net increase in earnings if Engineers' stockholder purchases Gulf States' common stock	$1.04"

There were many additional advantages to the common stockholders flowing from the simplification of Engineers. It was rid of the Puget Sound incubus.

The book loss has provided a cushion for Engineers for tax purposes in connection with the profits realized by the sale of Gulf States stock of over $8,000,000 with its federal income tax savings to Engineers and its common stockholders of over $2,000,000 and is a further cushion against the profit which may enure to Engineers, in the sale of its holdings in Virginia (R. 990a).[36] It should also be noted that the Puget Sound book loss was used to offset Engineers capital gain originating from the sale of El Paso Natural Gas stock indicating a further huge tax saving (R. 616a).

The common sought and obtained the right to eliminate the preferred from the enterprise. Having gotten the benefit of the receipt of the securities in the underlying companies and profited thereby, they now seek to further diminish the preferred's rights in the enterprise. If the common thought it had been unduly burdened by the simplification proceedings it might have allowed the preferred to continue their participation. In this connection it cannot be overlooked that by eliminating preferred the common stockholders obtained absolute control of the underlying operating companies directly. This transaction was "tax free" to the common stockholders of Engineers and to the limited group of preferred stockholders who owned common stock (R. 620a).

[36] Gains on future sales may still be applied against the book losses, under the carry-over provisions of the Internal Revenue Code until December 31, 1949.

PART ONE.

The Nature of the Liquidation.

I. Concerning the Contentions as to the Payment of Amounts in Excess of the Involuntary Liquidation Preferences upon an Alleged "Genuine Liquidation".

With respect to Point I of the Central-Illinois Brief, which urges the limitation of the preferred stockholders to $100 per share, allegedly pursuant to the provisions of the corporate charter, we shall demonstrate below that the dissolution of Engineers is not a "true liquidation" or a "genuine liquidation". The method employed by the common stock management which continued the common stockholders in control of the underlying companies had the same effect as a voluntary liquidation. The common stock management elected this method to keep the enterprise for the common stockholders and to get rid of the preferred stockholders by a cash payment on a basis similar to a voluntary liquidation. There appears no valid reason, other than self interest, for the common stock election to liquidate, and distribute the securities in the underlying operating subsidiaries, to the common and to exclude the preferred from the enterprise. It had all the earmarks of a voluntary liquidation and there is no reason why the call prices should not be paid to the preferred stockholders.[37] At all events Engineers' dissolution was not a "true" or "genuine" liquidation within the contemplation of the parties to the contract (charter). As has been

[37] The Commission stated: "Ordinarily a company in this position would exercise its call privilege and redeem the preferred at its call price (R. 60a)."

indicated elsewhere, this Court in the *Otis* case held that a liquidation under the Act was not the kind of liquidation envisaged by the charter and that Congress did not intend to mature the liquidation preferences in any event.

The attempted distinction in the Central-Illinois Brief between simplification and liquidation is untenable. The so-called liquidation of Engineers merely passes on to the common stockholders the securities in the underlying operating companies.

A. Concerning the Contention as to Payments in Excess of the Amounts of Contract Claims in the Light of Bankruptcy and Equity Reorganization Precedents.

The Central-Illinois group also asserts that the bankruptcy and equity reorganization decisions do not support payments to senior security holders of cash amounts in excess of their contractual claims applicable to involuntary liquidation or retirement of their security.[38] This assertion is inapplicable here. In the first place, any inference that the preferred are seeking more than their contract claims is unwarranted as well as "question-begging", for the basic issue is the value of these contract claims. In fact the Commission has limited the amount of the preferred compensation by the call provisions of the charter (R. 67a). In the second place, any implication that the involuntary liquidation provision of the charter is controlling in the instant case so as to limit the preferred claim to face value, is contrary to the *Otis* principle that the charter liquidation provisions are inoperative, in simplifications under the Act. Furthermore, while contract liquidation provisions are incho-

[38] Central-Illinois Brief, p. 34 ff.

ate and not controlling in simplifications under the Act so as to require valuation of the contract rights, the contract liquidation provisions are choate or matured in bankruptcy and equity reorganizations and hence conclusive as to the amount to be paid.[39] Into this latter category fall the cases[40] cited by the Central-Illinois counsel which involve claims matured in bankruptcy or equity reorganizations and which consequently are to be distinguished from the instant case involving an inchoate claim in a simplification under the Act.

Moreover if the Act were permitted to mature the preferred claim, as Central-Illinois seems to suggest, then the Act would create a windfall to the common since the Commission has found the fair investment value of the preferreds' claims, at least equal to the

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[39] As stated in the *Otis* case: "Congress did not intend that its exercise of power to simplify should mature rights, created without regard to the possibility of simplification of system structure, which otherwise would only arise by voluntary action of stockholders or, involuntarily, through action of creditors" (323 U. S. 638).

[40] The cases of *Knight* v. *Wertheim & Co.*, 158 F. (2d) 838 (C. C. A. 2, 1946), cert. den., *sub nom. McGuire* v. *Equitable Office Building Corp.*, 331 U. S. 818 (1947) and *In the Matter of Childs Co.*, Corporate Reorganization Release No. 67 (1946) obviously involve corporate reorganizations under Chapter X of the Bankruptcy Act. In *Bailey* v. *Minsch*, 168 F. (2d) 635 (C. C. A. 1, 1948), cert. den., 91 L. Ed. 38 (1948) (Advance Sheets) which involved an equity receivership in connection with Investment Company Act of 1940, the Court expressly noted the *dicta* in several cases under the Act [See *e. g., Mass. Mutual Life Ins. Co.* v. *S. E. C.*, 151 F. (2d) 424, 430 (C. C. A. 8, 1945), cert. den., 327 U. S. 795 (1946); *In re Consolidated Electric & Gas Co.*, 55 F. Supp. 211, 216 (D. Del., 1944); *In re North Continent Utilities Corp.*, 54 F. Supp. 527, 530 (D. Del., 1944)] that on premature retirement of bonds in simplification proceedings the Commission might find the equitable equivalent of the bonds to be more than the face amount but pointed out that "in the present case there has been no such finding, so the dicta in these cases is not pertinent" (168 F. (2d) 638). Also see discussion *infra*, p. 46.

call price or in excess of the involuntary liquidation amount and has concluded that the payment of such amount is fair and equitable. Such windfall or shift in values is to be avoided.[41]

Central-Illinois in the course of its discussion of the bankruptcy reorganization precedents apparently makes a significant admission.[42] Its counsel admits that payment may be made in new securities, rather than in cash but limits its concession to a case where "the enterprise is continuing". The brief then goes on to state that "because 'practical considerations' might make it 'impossible' for the reorganized enterprise to continue if the claims of the senior security holders are paid in cash (*Case* v. *Los Angeles Lumber Co., supra,* at 117), 'fairness and equity' authorize the senior security holders to be awarded the 'equitable equivalent', in new securities, of their contractual claims".[43] In other words, if it were convenient to pay the senior security holders in cash and eliminate them from the enterprise, the letter of the contract governs and the preferreds would be limited to $100. If on the other hand it was inconvenient (presumably because the cash was not available) the common stockholders at their option and for "practical considerations" might continue the preferred stockholders in the enterprise, in which event the senior security holders would get the "equitable equivalent" in new securities, for their contract claims. The effect of this would be to give $100 to senior security holders in a system like Engineers where ample cash and other assets were available to pay the call prices and

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[41] *Otis & Co.* v. *S. E. C.*, 323 U. S. 624, 637 (1945); *American Power & Light Co.*, H. C. A. R. No. 6176, p. 8 (1945).

[42] Central-Illinois Brief, p. 34 ff.

[43] Central-Illinois Brief, p. 35.

In other holding companies less fortunately situated, the senior security holders might receive the equivalent of their rights in securities. Such a result was never intended by Congress and should not be countenanced by this Court. Furthermore, in the bankruptcy reorganization involved in the *Los Angeles* case, the liquidation provisions matured and determined the exact amount of the cash payment, the equivalent of which in terms of new securities remained to be ascertained. Consequently, any implication that the medium of payment—cash or securities—increases or decreases the *quantum* to be received is erroneous. Full compensatory treatment must be made regardless of the medium of payment.[44] Moreover, as has been pointed out above, as the involuntary liquidation preference did not mature in the instant simplification, the cash equivalent of the contract rights surrendered had to be determined on a going concern basis in accordance with the principles of the *Otis* case.

B. Concerning the Contention as to Applicability of the Involuntary Liquidation Preferences of the Charter to the Instant simplification.

The Central-Illinois assertion[45] that the involuntary liquidation provision is applicable to the instant situation and is a conclusive measure of the preferred stockholders' claim has been rejected by the courts below (R. 288a, R. 34) and the Commission (R. 61a) on the basis of the correct application of the principles of the *Otis* case. We have also demonstrated in our own brief[46] the inapplicability of the Engineers charter involuntary liquidation provision as being a matter not within the contemplation of the parties.

[44] Streeter Brief, p. 29, n. 159.
[45] Central-Illinois Brief, p. 37 ff.
[46] Streeter Brief, p. 95 ff.

We have also shown that the involuntary liquidation provisions are not matured as a matter of the Congressional intention. In that connection, we pointed out that any type of dissolution, liquidation or simplification or any method of system adjustment "adopted as a matter of administrative routine" would not fall within the coverage of the charter.[47] *Otis & Co. v. S. E. C.*, 323 U. S. 624, 639 (1945). Consequently, the Central-Illinois effort to distinguish the *Otis* case on the basis of the prescience of the draftsmen of the Engineers charter[48] and the type of liquidation or simplification or method of system adjustment involved is unavailing.

C. Concerning the Contention as to the Inapplicability of the *Otis* Case as to an Alleged "Authentic" Liquidation.

The Central-Illinois group also urges the applicability of the involuntary liquidation provisions of the charter to the instant situation because of an alleged "authentic" or "genuine" liquidation or "final termination".[49] In this connection an effort is made to distinguish the instant case from the *Otis* case on

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[47] Streeter Brief, p. 98.

We have also urged in our brief (pp. 99-103) that if the charter provisions are operative, the instant liquidation is voluntary and falls within the voluntary liquidation preference.

[48] It should be noted that the charter provisions which were held inoperative in the *Otis* case were drafted in 1929. *A fortiori*, the provisions of the Engineers charter drafted in 1925 (R. 1403a) must be deemed inapplicable.

On the same reasoning the dissolution, even if viewed as a reduction in capital would not, despite the contrary contention of the Central-Illinois group (Brief, p. 50) fall within the charter. It should also be noted that on a "voluntary" reduction in capital resulting in a distribution of the assets to the stockholders, the preferred are entitled to their respective call prices (R. 1412a), although Central-Illinois refers only to the provision for payment of \$100 plus accrued dividends on a reduction in capital other than "voluntary". (Brief, p. 44).

[49] Central-Illinois Brief, pp. 45, *et seq.*

the ground that the *Otis* case involved a continuing enterprise as contrasted with an alleged "authentic" liquidation.[50] On the other hand, the court below, accepts the *Otis* principle that the charter provisions are not "dispositive", but criticizes (erroneously, we maintain) the Commission for allegedly disregarding the fact of the termination of the enterprise, which, in the opinion of the court below, "supplies the substantial difference between the instant case and the *United Light & Power Company* reorganizations [*Otis*]" (R. 36).[51] Thus the same alleged factual difference between the instant and *Otis* cases, *i. e.*, supposed "termination of enterprise" ("authentic" liquidation) vs. its continuance, provides the basis for a frontal assault by the Central-Illinois group and a lateral attack by the court below, upon the *Otis* principles. The discussion in our brief provides the same answer to these attempted distinctions and clearly exposes this fallacy.[52] It is clear from an examination of this Court's opinion in the *Otis* case that the fact that "the business * * * continues" is not material; that

[50] The following definition of a true liquidation has been suggested by Commissioner McConnaughey in the *El Paso* case where in dissenting he said:

> "'Liquidation' has various meanings depending upon the setting in which it is used. In its most generally accepted sense, as applied to corporate operations, the word describes a complete winding up that brings to an end the active participation in the going enterprise of all who theretofore had been associated together in it. Not only is the intangible corporate vehicle dissolved as is proposed here, but the rights and property with which the business had been conducted are disposed of and the proceeds distributed among all the participants in proportion to their interests. Thereafter none of them draws benefit from the continued operation of the enterprise. The interest of all participants is liquidated" (H. C. A. R. No. 5499, p. 14).

[51] The court below notes that in the "latter case [*Otis*] the security holder participation in the enterprise was shifted from the top holding company to a subsidiary holding company but the holding company enterprise as such continued" (R. 36).

[52] Streeter Brief, p. 96 ff., 138 ff.

charter preferences are not matured (as in a normal liquidation), "where liquidation is adopted as a matter of administrative routine"; that the dissolution under the Act and the Commission's administration thereof results in a "type of liquidation" entirely distinct from the "liquidation" envisaged by the charter provisions; and that the selection of one method of system of adjustment, to accomplish simplification "is an incident which ought not to affect rights". Procedural details, such as the selection of the method of system adjustment or of particular sequence should not affect substantive rights. It is certain that a "fortuitous"[53] choice of method and sequence should not have such an effect. *A fortiori,* a conscious, deliberate choice or selection of both time and method by a common stock management must be subjected to even more careful scrutiny to guard the rights of the preferred stockholders. Such caution is especially appropriate in the instant case, where the common stock management has made its choice[54] after considering and discarding a

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[53] See *In re Interstate Power Co.*, 71 F. Supp. 164, 168 (D. Del., 1947); *In re United Light & Power Co.*, 51 F. Supp. 217, 225 (D. Del., 1943). In the latter case, the same District Judge pointed out: "The choice of procedural alternatives should not affect the substantive rights of the common shareholders." The same principle must apply with the same force and effect to the "substantive rights" of the preferred stockholders.

[54] Commissioner Healy makes this interesting observation in his concurring opinion in *El Paso Electric Co.*, H. C. A. R. No. 5499 (1944), p. 12:

> "* * * there may be such circumstances attending a liquidation put through by common stockholders as to require a holding that they are acting improperly or inequitably or attempting to euchre the preferred stockholders out of their redemption premium rights."

In the light of Commissioner Healy's foregoing statement the following quotation from the record is extremely relevant (R. 845a-846a):

> "Q. Mr. Benjamin, is it a fair statement to say that at the time last September 5 when the directors decided to

[Footnote continued on following page.]

wide variety of plans[55] and decided to liquidate Engineers even though the Commission did not *direct*

[Footnote continued from preceding page.]

pay the $100 a share to the preferred stockholders of Engineers that they did not have before them any graphs, charts, or data with respect to future earnings or prospective earnings of Virginia, Gulf, and El Paso? A. That is correct.

Q. Would you say that it was also a fair statement that it was the intent and purpose of the majority of the Board of Directors of Engineers to retain all future interests and increments in the enterprise for the common stockholders?

* * * *

A. Yes.

Q. I believe you testified, first, this Commission has never directed Engineers to liquidate and, second, that the Board of Engineers might have decided to liquidate the Engineers Company voluntarily; is that correct? A. Yes.

* * * *

The Witness: By that I assume you mean initiate action to cause the stockholders to voluntarily liquidate, yes.

* * * *

Q. I believe you also testified that the Board of Engineers might have chosen to give the preferred stockholders a stake in the subsidiary companies had they so desired? A. Yes, I think I testified that they could have chosen other methods to meet the obligation of the preferred stock other than pay them in cash.

Q. In other words, the effect of what you are saying is that the Board of Directors of Engineers chose this method as a means of limiting the preferred as to the receipt of $100 and accumulated dividends to the date of deposit? A. I think that is right. In other words, the method followed by the plan provides for the payment in cash of the amount you stated and therefore limits them to that amount, yes, sir.

Q. The effect, Mr. Benjamin, of the Board's action in this respect would be to deprive the preferred stockholders of Engineers of any prospect of participating in the enterprise, its future earnings, and prospects. A. So far as this plan is concerned, yes.

Q. They will have no further interest in the going concern activities of Virginia, Gulf States, and El Paso? A. That is correct."

[55] See Streeter Brief, p. 9.

It is settled that the choice of appropriate method, from among available alternatives is left by the Commission to the Company, and here to a common stock management and that management exercises the dominant role in the presentation of a plan. See Streeter Brief, p. 140, n. 177.

the dissolution of the Company and a contemplated merger with its subsidiary, Virginia Electric and Power Company, would have been permissible.[56] This merger alternative, it should be noted, was dropped after ascertainment that a merger was not considered a dissolution within the meaning of the charter so that the statutory appraisal provisions of Delaware and Virginia might become applicable to the rights of the preferred stockholders.[57] Had this merger route been followed, the Central-Illinois contention as to the applicability of the charter involuntary liquidation preference to the instant situation and the attempted distinction of both courts below and Central-Illinois based upon the alleged termination of the enterprise, would of course have been unquestionably groundless and unmeritorious. The result cannot be different simply because the common stock management picks and chooses the steps and their sequence. This broad range of control which management (including the instant common stock management) possesses in the course of an 11(e) adjustment has been recognized in *S. E. C. v. Chenery*, 332 U. S. 194, 205, rehearing denied 332 U. S. 783 (1947), when this Court said:

> "* * * Added to these normal managerial powers, the *Commission pointed out that a holding company management obtains special powers in the course of a voluntary reorganization under §11(e) of the Holding Company Act. The management represents the stockholders in such a*

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[56] It was not the Act which compelled the relinquishment by the preferred stockholders of their interests in the enterprise but the considered decision of the common stock management which denied the preferred the privilege of sharing the "risks", "penalties", "burdens" and the "hardships" of the enterprise with respect to which the Central-Illinois group so bitterly complains.

[57] Streeter Brief, pp. 10-14.

reorganization, initiates the proceeding, draws up and files the plan, and can file amendments thereto at any time. These additional powers may introduce conflicts between the management's normal interests and its responsibilities to the various classes of stockholders which it represents in the reorganization. Moreover, because of its representative status, the management has special opportunities to obtain advance information of the attitude of the Commission.

"*Drawing upon its experience, the Commission indicated that all these normal and special powers of the holding company management during the course of a § 11(e) reorganization placed in the management's command 'a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes,* to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute.' * * *" (Italics ours.)

The various divestments[58] and the presentation of the 11(e) plan and its numerous amendments afforded the common stock management every opportunity, for the "battery of devices", placed in its command during the course of the instant simplification. By its action, the common stock management has excluded the preferred stockholders from the enterprise and terminated preferreds' (not common stock) interest in it through the device of retirement and acquired, for

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[58] Of the seventeen companies many were small and inconsequential; several of the others were merged into one or more of the principal underlying subsidiaries. Puget Sound has been referred to elsewhere as an economic burden (R. 1608a). See Streeter Brief, p. 7.

the common, direct ownership[59] of the enterprise by the method of distribution to the common stockholders of the securities in the three underlying operating companies. On the dissolution of Engineers, in place of their previous indirect ownership,[60] the common stockholders obtained the entire enterprise lock, stock and barrel. Thus the Engineers enterprise continues, albeit in different form, through the media of three operating companies. In any event, as indicated in our Brief (pp. 138-9), the *Otis* rule applies equally to a "true" or "genuine" liquidation, assuming *arguendo* that that is the fact here.[61] This principle

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59 The record is clear that the objective of the plan was to eliminate the preferred stockholders from the enterprise in a manner which would permit the common stockholders to obtain direct and complete ownership of the three subsidiaries (R. 819a). In fact Engineers had virtually 100% common stock control of these three companies and the handful of Engineers common stockholders owning 72% of Engineers common stock continued in the same relative position in these three companies. The enterprise was passed on perfectly to the Engineers common stockholders. Nevertheless, Central-Illinois in its brief (p. 7, n. 3; p. 39, n. 1) erroneously implies that the Engineers common stockholders did not gain complete control of the three operating companies, *i. e.*, Virginia, Gulf States and El Paso, by using the expression that the "common stocks of each company represent only a minority of the total capitalization of each company".

60 *American Power & Light Co.* v. *S. E. C.*, 329 U. S. 90, 116-7 (1946); *The North American Co.* v. *S. E. C.*, 327 U. S. 686, 709 (1946). Thus in the *North American* case, *supra*, this Court points out that a divestment or reorganization plan "may involve no more than a distribution of the securities among the existing shareholders of the holding company". Similarly in the *American Power & Light* case, *supra*, this Court indicates that a dissolution might "mean little more than the receipt of securities of the operating companies in lieu of their present shares" in the holding company and states: "Elimination of useless holding companies may be carried out by fair and equitable methods so as to destroy nothing of real value."

61 At the time of his opinion in the instant case, the District Judge (Leahy) rejected this same argument that the plan involves a "true liquidation" as distinguished from a "fictitious

[Footnote continued on following page.]

of the *Otis* case was recently reaffirmed in *Schwabacher v. United States*, 334 U. S. 182, 199 (1948), where after noting that corporate charters and state laws "usually have been drawn on assumptions that time and experience have unsettled", the Court said:

> "* * * we have held * * * that, as a matter of federal law liquidation preferences provided by the charter do not apply. We said that, although the *company was in fact being liquidated* in compliance with an administrative order, the rights of the stockholders could be valued '*on the basis of a going business* and *not as though a liquidation was taking place*'. Consequently the liquidation preferences were only one factor in valuation rather than determinative of amounts payable [Citing *Otis & Co.*]" (Italics ours.)

Furthermore, while the *Otis* case renders charter provisions inapplicable to a broad and unlimited variety of methods of system adjustment in the achievement of the objectives of the Act (whether involving a liquidation or continuance of the enterprise), the *Schwa-*

[Footnote continued from preceding page.]

liquidation" in the *Otis* case so that the charter provisions do apply. At that time he stated;

> "Although I have an entirely open mind on the question, *my present thought is that the rule of Otis & Co., applies also to a situation in which there is a true liquidation rather than a nominal or formal liquidation mainly because this is not a chang in corporate form contemplated by the charter.* But counsel argue forcefully that Otis & Co. by its stress that the court was there concerned with a continuing enterprise impliedly holds that a different result would obtain in a true liquidation. I think that perhaps Otis & Co. was not intended to go that far. When a novel question is before a court, it frequently grabs any and all reasons in support of its conclusion. It does not follow, however, that any one of those facts is the *sine qua non* for the decision" (R. 288a, n. 2). (Italics ours.)

bacher case declares the corporate charter inoperative in the limited type of recapitalizations of a continuing nature, for which the Interstate Commerce Act expressly provides. It is clear that the *Schwabacher* case was not intended to limit the broad scope of the *Otis* rule, of inoperativeness of the charter provisions.

II. Concerning the Contention That an Alleged Long Series of Decisions Precludes Payment to the Preferred Stockholders of More Than $100 Per Share.

Before addressing ourselves to certain erroneous legal contentions made by the Central-Illinois Group, we consider it appropriate to urge that the *method* of liquidation employed by Engineers common stockholders, was in essence, a matter of form in view of the fact that the common stockholders came up with the same control of the three principal underlying operating subsidiaries as they had when Engineers was alive. The common stockholders freed themselves of the continued expenses of the holding company and eliminated the preferred as an act motivated by self interest.

Central-Illinois (Brief, p. 56) squarely urges that the senior security holders are entitled to a fair investment value of their interest only if they are "*forced*" to continue in the enterprise. Carried to its logical conclusion it is suggested that, assuming the application of the *Otis* case principles and applying the fair investment value doctrine to the liquidation of all intermediate holding companies in a system, except the top holding company, if, when and as the common stockholders decide to liquidate the last holding company in line, that the choice is theirs, either to pay the preferred $100 per share in cash or to con-

tinue the preferred in the enterprise; and in the latter event, albeit grudgingly, it is admitted that the preferred would have a right to a determination of the fair investment value of their interest. Stated bluntly Central-Illinois contends that under those circumstances the common have the choice of paying $100 in cash or giving the preferred, securities of a going concern value equivalent to the call price. We ask if this is equity? Can the common stockholders who control the reorganization process have the choice of methods and procedures and at their particular whim decide such a fundamental question? Furthermore, where as here, the common stockholders deliberately exclude the preferred from any possibility of participating in a continuation of the venture, *i. e.*, receiving a fair portion of the underlying securities, can the common be heard to complain if the Commission, completely cognizant of the common stockholders' decision, fixes the amount at a sum equal to the fair investment value of the preferred?

Throughout the Central-Illinois Brief (p. 59 ff.) the contention is made that the junior security holders have suffered deprivations of a far reaching character as the result of the liquidation of Engineers. These facts are not borne out by the record and are in effect, contrary to the findings of the Commission based on evidence in the record.[62] By way of illustration, the contention is made that huge losses were occasioned by the Act as a result of the divestment

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[62] The Commission found that the "retirement of the preferred stock will be of immediate benefit to the common stockholders" and that the elimination of the prior charge "is highly beneficial to the common" and "hastens the day when the common will begin receiving dividend income" (R. 69a).

by Engineers of Puget Sound.[63] In the first place, the investment in Puget Sound was made solely by the common stockholders. The preferred had no vote in the matter. In the second place, before the Engineers simplication proceedings had gotten under way before the Commission, the common stockholders created a reserve of $35,000,000 for the Puget Sound loss which had long been recognized as having in reality occurred at least prior to registration by Engineers with the Commission. Thirdly, such assumed "losses" would have all been previously absorbed and reflected in the present values of the common and preferred stocks. (For a detailed presentation of the true facts regarding Puget Sound, this Court is respectfully referred to the Commission's Brief, p. 59 *et seq.*)

On page 62 in Central-Illinois Brief the contention is made that the preferred stockholders seek payment "for their 'disappointed expectations'". The preferred stockholders had a right to believe that the directors of the company were acting for all stockholders and not merely for the common. Implicit in the contract between the preferred stockholders and the company was the thought that a plan propounded by a management would give proper consideration to the rights of the preferred as well as the common. In this regard the common stock management utterly failed in the discharge of their fiduciary duties. It was this fact that impelled Thomas W. Streeter, an independent director, to insist that the preferred's rights be

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[63] The alleged Puget Sound loss is discussed in the Streeter Brief, p. 120 ff. The nature of the proof of loss has been discussed *supra*.

protected. He knew, as did the Commission, that the preferred stockholders have a right or expectation to be treated like the common stockholders as far as participation in the underlying securities, was concerned. He felt it most unfair, as did the Commission, to leave to a common stock management the deliberate decision to exclude the preferred from participation in the underlying companies. One need not argue frustration or rescission. One need only to look at "what happened" to see where the real equities lie in this situation. In any event, as will be demonstrated below, the preferreds are not seeking compensation for "disappointed expectations", but the current going concern value of their contract rights in accordance with the principles of the *Otis* case.

The Central-Illinois suggestion that the Commission created a "new fictional doctrine * * * designed to free the Commission not only of the limitation stemming from the contractual arrangements of the parties, but also from the settled principles found in the 'fair and equitable' standard of 11(e) by the Commission and the Courts"[64] is a grave and ill-founded charge. The Commission created no new fiction but conscientiously followed the principles laid down by this Court in the *Otis* case. We ask the Court to compare the 60 page detailed carefully drawn opinion of the Commission (R. 25a-85a) in the instant case, representing the culmination of a 10 year background and the complete knowledge and familiarity of every fact relating to Engineers and its subsidiaries with the

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[64] Central-Illinois Brief, pp. 64-5.

opinion of the District Court, referring as it did to the 4 items of colloquial equity.[65]

As we understand the Central-Illinois contentions, its argument amounts to something like this. The contract prevails and the preferred can only receive $100 per share, if the common stockholders want to pay cash and get a bargain by excluding the preferred and keeping all the benefits of the underlying securities upon the so-called liquidation of the top holding company. On the other hand if it is to the best interest of the common to permit the preferred to continue to have a stake in the enterprise, then and only then, can the preferred hope to receive its fair investment value. To state the contention is to supply the answer.

In addition to the foregoing general contentions, the Central-Illinois group also urges that the "rights of senior security holders to premium payments upon the forced liquidation of *their enterprise* or the retirement for *cash* of their securities, where the contractual provisions were deemed not applicable",[66] is to be determined by the doctrine of frustration of enterprise, which allegedly limits the preferred to $100 per share. Passing over the characterization of "premium", which is a favorite Central-Illinois method for begging the question, we hasten to agree that the *preferred stockholders have been forced out*

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[65] As far as we know the instant case is the one and only experience that the District Judge had with the entire Engineers proceeding. During the course of the divestment proceeding over approximately ten years, the Commission has had occasion to investigate and study factual and technical data pertaining to the entire Engineers' system. During this same period, as a result of various applications made, the Commission has had further opportunity to scrutinize the affairs of the subsidiaries of the Company. This wealth of knowledge provides the Commission with the requisite background for its action in the instant case. See Streeter Brief, p. 8; R. 69-70, *supra*, p. 17 ff.

[66] Italics ours. Central-Illinois Brief, p. 51 ff.

of the enterprise and compelled to accept cash instead of the "risk" of participating in the securities of the underlying operating subsidiaries, by the deliberate maneuverings of the common stock management, as a consequence of which the poor unfortunate common alone have become "burdened" with the direct ownership of three flourishing companies. In support of its position, Central-Illinois recites quotations from cases and S. E. C. briefs almost all preceding this Court's opinion in the *Otis* case, surrounding them with superficially impressive and detailed descriptions of the deprivations and losses which have been inflicted *solely* upon the common, who made a final noble "sacrifice" by forcibly ejecting the preferred from sharing the future "risks" and "losses" flowing from participation in the three excellent principal underlying companies. Certainly, if the doctrine of frustration is realistic and not fictional, it is not applicable here. It is self-evident that the real living enterprise has not been frustrated. Engineers has been technically eliminated but the enterprise has actually been passed along to the common stockholders.

Contained in the discourse of Central-Illinois is a concept, which is not too clearly delineated—*i. e.*, the impact of the doctrine of frustration upon the *Otis* case and vice versa. Central-Illinois claims in this connection that the "rationale of the *Otis* case certainly does not justify the abrupt rejection of the principle of 'frustration'" and contends that in the *Otis* case, " 'fairness and equity' permitted the preferred stockholders to receive the 'equitable equivalent' of their claim on earnings because they remained investors in a continuing enterprise".[67] Central-Illinois

[67] Central-Illinois Brief, p. 65.

then seeks to give new life to and inject the doctrine of frustration into the law of corporate reorganization by virtue of this Court's "Cf" citation of *New York Trust Co.* v. *Securities and Exchange Commission*, 131 F. (2d) 274 (C. C. A. 2, 1942), cert. den. 318 U. S. 786 (1943), and *In re Laclede Gas Light Co.*, 57 F. Supp. 997 (E. D. Mo. 1944), in the *Otis* case. Examination of the context of the *Otis* opinion, in which the reference is made, clearly reveals its support of the principle of inoperativeness of the charter provisions in the light of the *unforeseeability* of the legislative policy, as enunciated by this Court. The stress is clearly upon the aspect of *unforeseeability* which is discussed in both the *New York Trust Co.* and *Laclede* cases. Certainly this Court did not intend to measure the rights of the parties in a simplification by the doctrine of frustration, as Central-Illinois urges. Moreover, despite any contrary Central-Illinois reference, the doctrine of frustration has historically not been "part and parcel" of the "fair and equitable" standards in the law of reorganization, although the doctrine of frustration is part of the law of equity. This supposed "apt solution", which is urged, would always result in the elimination of senior securities at face amounts (regardless of their intrinsic value) and would make mockery of the *Otis* doctrine of valuation on a going concern basis. In other words, Central-Illinois, despite its denial, seeks to substitute the doctrine of frustration (under which the contract provisions are admittedly inapplicable) for the *Otis* principles of full priority and valuation "on a going concern basis", or "as though in a continuing enterprise", in the measurement of the rights of security holders upon a simplification under the Act, and thus

again laterally attacks, the *Otis* case. The mandate of this Court is clear that in the simplification of a holding company system, "the rights of the stockholders of a solvent company are to be evaluated on the basis of a going business" and not determined by the application of the doctrine of frustration. Furthermore, if the Central-Illinois analysis is correct, then the *Otis* case applies only where a common stock management elects to permit the preferred to remain in the enterprise or participate in the underlying companies, and not where the common stock chooses to pay the preferred off in *cash*. Such a personal choice by the common stock management was never intended to have the effect of altering valuable rights of nonvoting preferred stockholders. Moreover, compensatory treatment must be accorded the security holders, whether the medium of payment be cash or securities.[68] Contrary to the Central-Illinois interpretation of the *Otis* case that " 'fairness and equity' permitted the preferred stockholders to receive the 'equitable equivalent' of their claim on earnings because they remained investors in a continuing enterprise", our reading of the *Otis* case disclosed that the question there was whether the common, not the preferred, should receive *any* participation or "be deprived of its possibility for future earnings". The conclusion that the common should receive a participation was clearly based upon a valuation of the stockholders' rights "as though in a continuing enterprise."[69] As heretofore noted, the situation is quite reversed. The common has kept the enterprise and attempts to justify payment to the preferred of $100

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[68] See Streeter Brief, p. 129, n. 159.

[69] The phraseology "as though" implies the possibility or contingency of the nonexistence of the continuing enterprise.

on the theory of "frustration". The Central-Illinois effort to substitute the doctrine of frustration for the concept of valuation on a going concern basis, and the principle of full priority as incorporated in the fair and equitable standard in simplifications, must be rejected as unsound and contrary to the views of this Court in the *Otis* case.

The Central-Illinois group also claims that this doctrine of frustration "was consistently applied by the Commission and the Courts to limit preferred stockholders and bondholders to the face amount of their securities".[70] However, it cannot be denied that under the application of the fair and equitable standard, the Commission and the courts also have permitted the retirement of senior securities at amounts in *excess* of their face values.[71] Therefore, neither the

[70] Central-Illinois Brief, p. 55.

[71] For example, *The Western Public Service Co.*, H. C. A. R. Nos. 3175, 3230, 3245 (1942) and *El Paso Electric Co.* (Delaware), ~~8 S.~~ E. C. 366 (1941), which were subsidiaries of Engineers; *Mississippi River Power Co.*, H. C. A. R. No. 5776 (1945); *The North American Co.*, H. C. A. R. No. 5796 (1945); *Minnesota Power and Light Co.*, H. C. A. R. No. 5850 (1945); *NY PA NJ Utilities Co.*, H. C. A. R. No. 5975 (1945); *Buffalo, Niagara and Eastern Power Corp.*, H. C. A. R. No. 6083 (1945); *Pennsylvania Power & Light Co.*, H. C. A. R. No. 6167 (1945); *Standard Gas and Electric Co.*, H. C. A. R. No. 6435 (1946), following the decision in *Standard Gas & Electric Co.*, 63 F. Supp. 876 (D. Del. 1945); *Community Gas & Power Co.*, H. C. A. R. No. 6436 (1946); *Scranton Spring-Brook Water Service Co.*, H. C. A. R. No. 6458 (1946); *Northern States Power Co.*, H. C. A. R. No. 6578 (1946); *Pennsylvania Edison Co.*, H. C. A. R. No. 6723 (1946); *Washington Railway & Electric Co.*, H. C. A. R. No. 7410 (1947), enforced June 16, 1947 (D. C. Dist. of Col.); *United Gas Corp.*, 58 F. Supp. 501 (D. Del. 1944); *Central & Southwest Utilities Co.*, 66 F. Supp. 690 (D. Del. 1945); *In re American and Foreign Power Company*, 80 F. Supp. 514 (D. Me., 1948); *Pennsylvania Edison Co.*, H. C. A. R. No. 8550 (1948).

Several cases have also pointed out that in some situations the

[Footnote continued on following page.]

face amount nor a premium should automatically be paid upon the retirement of a senior security. The factual situation determines the amount to be paid the security holder.[72] Thus in *Massachusetts Mutual Life Ins. Co.* v. *S. E. C.*, 151 F. (2d) 424, 430 (C. C. A. 8, 1945), cert. den. 327 U. S. 795 (1946), the Court of Appeals for the Eighth Circuit pointed out:

> "Obviously, whether, upon retirement of outstanding bonds in the reorganization of an operating utility subsidiary, payment of principal, accrued interest, *and* redemption premiums is the equivalent of the bondholders' rights *depends upon the facts of each particular case.* The proper measure of such equivalence is for the determination of the Commission in the first instance, and its expert skill in appraising the facts to be considered must be accorded due weight by the court." (Italics ours.)[73]

Such approach permits the case by case evolution of the statutory standard.[74] In accordance with such

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[Footnote continued from preceding page.]

Commission might find the equitable equivalent of the senior securities to be more than the face amount. See e. g. *Mass. Mutual Life Ins. Co.* v. *S. E. C.*, 151 F. (2d) 424, 430 (C. C. A. 8, 1945); *In re Consolidated Electric & Gas Co.*, 55 F. Supp. 211, 216 (D. Del., 1944); *In re North Continent Utilities Corp.*, 54 F. Supp. 527, 530 (D. Del., 1944). The correctness of this view was also conceded by the District Court, as well as counsel for Central-Illinois (R. 223a-224a).

[72] *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194, 203, rehearing denied 332 U. S. 783 (1947).

[73] The same view was expressed by the District Court in its opinion (R. 288a) as well as in the course of the hearing (R. 223a-224a).

[74] The *Otis* case which rendered inoperative charter provisions and required the valuation of the security interest on a going concern basis undoubtedly accelerated the evolutionary process.

[Footnote continued on following page.]

evolutionary process, it is clear that an automatic rule for the retirement in all cases at $100 would be unsound and inequitable. *American Power & Light Co.*, H. C. A. R. No. 6176 (1945). In that case, where the so-called frustration cases were distinguished, the Commission, in line with the foregoing reasoning correctly rejected the automatic rule for the payment of the face amount stating:

> "* * * As a result of the experience gained through consideration of a large number of later cases, we are persuaded that an automatic rule of 100 in all debt retirement cases would produce inequitable results and that it is necessary to inquire into the circumstances of the particular case to determine whether the payment of 100 is fair and equitable" (H. C. A. R. No. 6176, p. 12).

Accordingly, the Commission's decision in the instant case was merely an extension of the above principle to the retirement of the preferred stock. Moreover, if by the frustration cases, the Commission is deemed to have announced an automatic rule denying the pay-

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[Footnote continued from preceding page.]

In the evolution of the appropriate principles to achieve the statutory objectives, it is not to be unexpected that the Commission counsel and the Commission, like the courts, may waver at times and evidence a measure of inconsistency over the span of time. Furthermore, although the briefs submitted on behalf of the Commission are interesting in litigation such as this affecting the public interest, it is likely that its views have not always been wholly and completely accepted by the courts, even where the Commission's action has been sustained. Hence the statements in the briefs submitted on behalf of the Commission in past litigation must be weighed in the light of views enunciated by the courts.

Furthermore, it is noteworthy that in many of the earlier cases no proof was offered to the Commission with respect to the going concern value or the fair investment value of the preferred stocks. *American Power & Light Company*, H. C. A. R. No. 6176 (1945), p. 11.

ment of any amount in excess of stated value, then its decision in *American Power & Light Co.*, H. C. A. R. No. 6176 (1945), plan enforced (S. D. N. Y., 1945) constituted the announcement and application of a new principle based upon administrative experience under the Act, the extension of which, to the retirement of the preferred was made in the instant case. Even if the Commission has thus announced a new principle, such action is not forbidden and is entitled to the greatest weight, since it reflects the informed expert judgment of the Commission and is the product of administrative experience, appreciation of the complexities of the problem and a realization of statutory policies.[75] Since the parties represent *ownership* interests, there is no more reason for giving to the preferred stockholders merely the sums paid in by them, than there would be to restrict the common to the amounts they have contributed. Moreover, since in the event of rescission, there are no governing provisions in the charter, an appraisal was in order and, in line with the requirements of "strict priority" and "fairness and equity", the Commission properly found the preferred to be entitled to the investment value of their stock.

III. Concerning the Contentions as to Alleged Serious Constitutional Questions.

The spectre of the Fifth Amendment, which the Central-Illinois group originally raised has apparently disappeared.[76] Its lack of merit must have finally become obvious to the Central-Illinois group. In any

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[75] *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194, 207, rehearing denied 332 U. S. 783 (1947).

[76] Central-Illinois Cross-Petition, p. 5.

event, such contention has been demonstrated to be unsound.[77] In place of the Fifth Amendment contention, the Central-Illinois group now urges an unconstitutional delegation of power because of the alleged absence of a standard to guide the Commission in the exercise of its power (presumably in violation of Article I of the constitution). The uncertainty of the fair and equitable standard which Central-Illinois suggests is imaginary and nonexistent. The fair and equitable standard under section 11(e) of the Act is as clearly ascertainable and definite as the standards under section 11(b)(2) which this Court has sustained. Accordingly, a ready answer to any contention of an unconstitutional delegation (as well as a supposed violation of the Fifth Amendment) is contained in the opinion of this Court in *American Power & Light Co. v. S. E. C.*, 329 U. S. 90, 104-5 (1946).

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[77] Streeter Brief, p. 103 ff.

PART TWO.

The Valuation Process.

Throughout Part Two of its Brief, Central-Illinois seeks to bolster the District Court's erroneous valuation and technique and to reconcile the differences between the views of the courts below by reference to matters either outside the record, or to events subsequent not only to the decisions of the Commission and the two courts below, but subsequent to the actual consummation of the plan in the middle of 1947 (excepting the escrow arrangement). Presumably in accordance with the direction of the court below that the Commission ascertain and apportion earning power (R. 35) (which direction we have urged in our Brief is unwarranted), Central-Illinois counsel criticizes the Commission for its failure to make such ascertainment and apportionment, but passes over without comment the District Court's neglect to do so while arguing the need therefor and then proceeds to supply the supposed deficiency by his own "expert" evaluation. It is submitted that such Central-Illinois process of valuation can be no substitute for that made by the Commission. In order to focus attention on the valuation technique proposed by Central-Illinois, we shall first address ourselves to an over all discussion of the approach of the two courts below and their supplementation by Central-Illinois and will then comment briefly on the various erroneous legal contentions of Central-Illinois.

As noted elsewhere,[78] the District Court actually failed to value the three series of Engineers pre-

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[78] Streeter Brief, p. 113.

ferreds. Although stating that the involuntary liquidation provisions did not govern, the learned District Judge fixed the value of the three series at $100 per share, which "happened" to be the involuntary liquidation price provided in the charter for all three series, even though they all carried different dividend rates. The District Court reached this conclusion by reference *inter alia*, to four colloquial equities heretofore discussed. It has been demonstrated that these elements were very carefully considered by the Commission and were entitled to far less weight than the current rights to earnings and assets which are entitled to primary emphasis.[79] Even the court below decided that the District Court had erronsously indulged in a "species" of valuation, which it decided the District Court could not do and by reason thereof remanded the proceedings to the Commission for redetermination on the question of valuation.

Central-Illinois has, in addition to attempting to support the District Court's opinion on valuation, another objective for the inclusion of the various financial data, computations, calculations, comparisons, etc., and that is to cast doubt on the so-called "predictions" made by Dr. Badger. The fact is disregarded that the District Court in May, 1947, specifically stated (R. 290a): "I accept Dr. Badger's values and, in the absence of a showing of changed circumstances, I shall assume that those values are applicable at the present time." Despite that statement, Central-Illinois consumes many pages and injects innumerable footnotes seeking to establish, by innuendo, that there have been such changes. If such changes have in fact occurred, they must, of necessity, have taken place subsequent to the consumma-

[79] Streeter Brief, p. 113, ff. 124.

tion of the plan in mid-1947. It is, of course, our view that no change of a material character has taken place. In this connection, it is again worthy of note that Central-Illinois not only does not seek a remand, but specifically opposes a remand to the Commission, and, in effect, asks this Court to substitute the District Court's valuation for the Commission's.

Recognizing, of necessity, the District Court's reference to the four colloquial equities as a basis for disapproving the Commission's detailed findings on value, to be hopelessly inadequate, Central-Illinois resorts to a great mass of statistics and calculations, hypothetical cases, newspaper articles, financial publications and current market prices of securities, much of the data being subsequent to the consummation of the plan in the middle of 1947, to suggest to the Court that \$100 per share for the preferred stockholders in this case is "enough", and also to cast doubt on the validity of the valuations made by Dr. Badger and the Commission.

It is obvious to this Court that it is not possible to try this case over again in the briefs submitted, or in oral argument. It is extremely difficult to cull out from the Central-Illinois Brief the innumerable statements and conclusions which are both incompetent and irrelevant. It is our contention that the footnotes and so-called financial arguments based on matters occurring long subsequent to the Commission's decision, and many referring to events subsequent to the consummation of the plan, are entirely foreign to the issue before this Court. However, because of the great stress and the amount of space devoted to a consideration of these items by Central-Illinois, in its Brief, we felt impelled to show that the conclusions based upon such data, are entirely erroneous.

Before taking up in detail the various highlights of the Central-Illinois contentions regarding the general subject matter, it appears worthy of comment that counsel for Central-Illinois has freely given the Court the benefit of his "expert" opinion as to the relative merits of various preferred stocks, comparing them with Engineers and with other companies and engaging in the most widespread speculation leading to conclusions which are given an air of finality. A brief reference is made here and there to changes in the earnings of one or more of the underlying subsidiaries of Engineers with the implication that the poor common stockholders of Engineers had foisted upon them, the dregs of what was left, after the preferred took the cream from the top of the bottle. No effort is spared in the attempt to establish the "bad deal" the common got. It is suggested that the Commission and Dr. Badger failed to give any consideration to the future. Nearly everything that has happened in the last three years is literally dragged in, in an effort to show that the forecasts made by Dr. Badger were inaccurate.

Nowhere is it asserted in the Central-Illinois Brief that the three underlying operating subsidiaries, to wit, Virginia, Gulf States and El Paso, had retrogressed or changed so materially as to warrant a reopening of the instant proceedings on the ground of changed circumstances.[80] Dr. Badger testified in January, 1946, and a reasonable period was covered by his forecast (R. 2103a quoted *infra*, p. 55). As was said in *St. Louis Southwestern Ry. Co.* v. *Henwood*, 157 F. (2d) 337, 395 (C. C. A. 8, 1946), cert. den. 330 U. S. 836 (1947), rehearing den. 331 U. S. 870 (1947): "What were their 'prospective earnings' * * *, have

[80] Cf. *Insurance Group Committee* v. *Denver & R. G. W. R. Co.*, 329 U. S. 607 (1947).

now become actualities". Three years have gone by and yet, outside of an isolated reference or two to the underlying subsidiaries, nowhere in the Central-Illinois Brief is it asserted that the evidence of past earnings and past financial condition, with the voluminous evidence bearing thereon before the Commission and considered by it, differed in any material respect, from the earnings and financial condition of the three underlying companies for the period 1946, 1947 and 1948. Central-Illinois makes no claim that the assets, earnings, earnings ratios, equities and general financial condition of each of the three underlying companies are anything but satisfactory and in accord with the expectations of Dr. Badger and the Commission. The major exception to this is the reference to the decline in earnings of Virginia and the explanation for this appears at p. 60, *infra*. There is nothing asserted in the record to question the predictions made by Dr. Badger (R. 2103a) to the effect that the three underlying operating companies should continue in future years to register progress along with other units in the industry. Dr. Badger's testimony in this regard appears to be particularly pertinent:

> "This estimate of 1946 earnings indicates a continuation of the improvement in earnings shown for the 1940-1945 period, as coverage, both in respect to over-all charges and Parent Company preferred dividends, is estimated to be higher in the year 1946 than in any of the years 1940 through 1945.
>
> "The public utility industry has for many years been characterized by stability and by a strong growth trend. There are no peculiar economic characteristics in respect to the territories served

> by the present subsidiaries of Engineers Public Service Company which would indicate that the earnings trend of these companies would go counter to that of the industry. It is a reasonable assumption, therefore, that this Company should continue in future years to register progress along with other units in the industry" (R. 2103a).

It appears that changes in economic conditions and money rates, down to December, 1948, have no bearing upon the fair investment value of the preferreds as of a date subsequent to the consummation of the plan. The increase in the yields of the various classes of securities referred to has been of modest proportions, and we submit that interest rates still are at historically low levels. The argument by Central-Illinois that the "percentage" increase in the yields of these securities presages a fundamental increase in the level of interest rates, appears unfounded. In effect, the past increases represent normal fluctuations and are not a forerunner of any fundamental change in money market conditions and of long-term interest rates.

The Chairman of the Board of Governors of the Federal Reserve System made the following significant statement on October 26, 1948:

> "When you consider that the public debt is one and a half times all other debt in the country combined, it seems obvious to me that the market for the Government debt securities must be one where investors can deal at all times with confidence, I remain of the conviction that for the foreseeable future the support program should be continued. This conviction is shared by all

of the Board of Governors, ten members of the Federal Open Market Committee, and by the Treasury. It is also supported by the weight of financial opinion in the country."[81]

The Government, to finance its expenditures successfully, must maintain stable market conditions for its securities. Because such confidence is predicated upon maintaining the existing support prices on long-term Government bonds, it is improbable that the general level of interest rates will increase further. In fact, it appears quite possible that in the near future, interest rates and preferred stock yields will recede from present levels. Apparently Dr. Badger's predictions in early 1946 that there was no indication of a substantial fundamental change in respect to money rates in the reasonably foreseeable future was correct.

We believe it might be helpful to the Court to comment on certain of the portions of the Central-Illinois Brief wherein are references to data from which the Court is asked to conclude that the value found by the Commission as being fair, just and equitable for the preferred stockholders, "could not exceed $100." This material refers mostly to arguments based on statistical data relating to matters allegedly occurring subsequent to the District Court's decision, which virtually coincided with the consummation of the plan, *i. e.*, about the middle of 1947. Thus, reference is made in the Central-Illinois Brief (p. 12) to the Federal Reserve Bank Index of Utility Stock Prices for the period from June, 1946, to December, 1947. This reference is made in the

81 As reported in *The Commercial and Financial Chronicle*, November 4, 1948, p. 40.

hope that this Court will assume that Engineers and its subsidiaries all followed the same trend and that there was, in effect, a 28 percent decline in "value" of underlying securities. This is the Central-Illinois "momentary market price" theory.

At page 14 of Central-Illinois Brief and elsewhere, as noted heretofore, a studied effort is made to persuade this Court that "market prices" chosen at a particularly haphazard time, were the *only* basis for the Commission's valuation. An attempt is made to imply something sinister in the Commission's considering market values of comparable listed securities as *one* of the many elements of an expert appraisal along with history of the enterprise assets, earnings, coverages, ratios, etc. Any expert or expert body that did not consider market value of listed securities as one of the elements of value, would not be doing its job correctly. Furthermore, the fact that market prices may fluctuate, does not in any way mean "intrinsic" or "economic" values, are to be redetermined on a "ticker tape" basis. That would not be "going concern" value. Actually, the changes in money rates have been comparatively insignificant and inconsequential, and the large cushion of investment value of the three series of preferred *above* their respective call prices as found by the Commission (R. 66a) should serve as an ample margin to take care of such changes.

On page 66 footnote 1 appears an example of Central-Illinois counsel giving their expert opinion as to the comparative investment values of many senior securities referred to in various Commission decisions. We are sure that the Commission is not unfamiliar with its own decisions and findings in the cases referred to, and must be deemed to have had them in

mind, in reaching their conclusion in the Engineers case.

Regarding comments appearing on pages 77 and 78, we have heretofore exposed the fallacy of the contention that temporary market prices, at a particularly haphazard moment, constituted the only element of value considered by the Commission. In footnote 1 on page 77, market price ranges of certain companies referred to by Dr. Badger in his report and taken from Moody's *Public Utilities, 1946* are presented to discredit the report of Dr. Badger and the Commission's findings. We think it may be fairly assumed that the Commission is no stranger to Moody's, and the reference thereto hardly justifies a complete reversal of the Commission's decision.

On page 81 and elsewhere the false assumption again appears "that the Engineers' preferreds had a value approximating the redemption prices based exclusively on market prices as of January 4, 1946 . . .," and the contention is made based upon hypothetical premises and "expert opinion" by counsel for Central-Illinois, that there was a failure to consider the element of "permanence" of the valuations as found by the Commission. The answer to these contentions would appear to lie in the complete absence of any showing by Central-Illinois that the three underlying operating companies have done other than prosper, during the last three years and amply justify Dr. Badger's predictions that he thought that these companies would progress as well as other units in the industry (R. 2103a).

At page 95, in footnote 1, Central-Illinois makes one of its few references to one of the underlying subsidiaries of Engineers. It then goes on to state that the common stockholders of Engineers received

1.45 share of Virginia common stock for each share of Engineers common owned. The footnote states:

> "* * * In 1946 * * * earnings available for Virginia's common stock were \$5,027,740, equivalent to \$1.71 per share of common (Moody's, Public Utilities 1948, p. 745). For the 12 months ended September 30, 1948, earnings available for Virginia's common were \$4,062,427, equivalent to only \$1.37 per share on the number of shares then outstanding, and additional shares are now being sold which will further dilute per share earnings (Moody's, Public Utilities, Current Supplement, Vol. 20, p. 1745)."

The unfairness of asking this Court to draw any conclusions from these isolated fragments from Moody's publication is clearly shown. What Central-Illinois does not state is what appears at page 9 of the Prospectus of Virginia Electric & Power Company dated November 15, 1948,[82] as follows:

> "It is estimated that the net sum of operating expenses and depreciation would have been reduced by \$1,500,000 if the new Possum Point generating station had been in operation through the 12 months ended September 30, 1948. It is presently scheduled for operation in November or December, 1948."

It thus appears that by the company's own statement it can look forward to increased income of \$1,500,000. It further illustrates the complete futility of this Court attempting to reach a decision on the matter of valuation, based upon fragmentary excerpts from periodicals and statistical documents, where, by ac-

[82] Virginia has recently filed with the Commission a registration statement under the Securities Act of 1933 with respect to the shares of common stock referred to in the said Prospectus.

cepting isolated statements, taken out of context, a completely misleading impression of the factual situation, may result.

At page 96, the conclusion is asserted by counsel for Central-Illinois that whether the valuation of the preferred is viewed in the light of the record *subsequent* to Engineers dissolution or in the light of the entire record prior, as well as subsequent, to dissolution the Commission's valuation cannot be justified. We challenge that statement.

In effect, what Central-Illinois is asking this Court to do is to fix $100 valuation based upon a mass of confused and irrelevant data, a good portion of which is allegedly based on happenings after the common forced the preferred out and compelled them to take $100, took away their stock certificates, cut off their dividends while the litigation was pending, and are now attempting to apply a completely false theory of the current market price approach, to keep the preferred from receiving the fair value of their interest as found by the Commission.

At page 97 (which is a continuation of footnote 1 on page 96) another "hardship" argument is advanced that because of Engineers dissolution, it lost the advantage of filing consolidated tax returns with one or more of its subsidiaries. The reason for the filing of consolidated returns was related to the excess profits tax that was in existence at that time (R. 837a). It also appears that after the repeal of the Excess Profits Tax Law (1945), the advantage of Engineers filing a consolidated return with Virginia was rather slight (R. 833a, 834a, 835a). At all events, aside from the fact that this question of consolidated returns must have been carefully considered by the common stock management, it was the voluntary action of the common to do this. Furthermore, there are a

number of tax *advantages* to the common stockholders, which the Central-Illinois brief does not mention.

First, in the Virginia Electric & Power Company prospectus of November 15, 1948, page 28, it appears that Virginia expects a *tax refund for overpayment of Federal taxes on income of $1,831,182.79*.[83] This anticipated refund is a tidy sum, of which the common are the "residual" owners, as a result of apparently a $5,000,000 tax refund claim of Engineers, as to which there was a "dearth of evidence" in the record (R. 56a).

Second, it is clear that there was a profit realized by Engineers on the sale of warrants of Gulf States Utilities Company, whereby the Engineers common stockholders acquired common stock of Gulf States at $11.50 a share. This transaction was consummated in June, 1947, with a resultant profit to Engineers of nearly $8,000,000,[84] which would normally have been subject to a capital gains tax of 25 percent, except for the following facts. In 1944 Engineers had sold its common stock holdings of Puget Sound Power & Light Company with a resultant capital (book) loss of approximately $33,000,000, a portion of which capital loss was used to set off against capital gain originating principally from the sale of El Paso Natural Gas stock so as to leave available a net capital loss carry-over from 1944 of approximately $31,000,000 (R. 616a). The capital gain from the sale of Gulf States rights would of course also be offset against the Puget Sound loss. Thus Engineers did not pay any Federal income tax on the profit realized through the sale of the Gulf States warrants. This involved a

[83] Prospectus of Virginia Electric and Power Company, dated Nov. 15, 1948, p. 28.

[84] R. 988a-989a. See discussion, *supra*, at p. 24.

saving for the common stockholders of almost $2,000,000.

Third, there still remains of the Puget Sound capital loss, a balance of approximately $23,000,000 available for set-offs of capital gains, for the taxable year of 1949, since carry-forwards of capital losses are continued for 5 years after the capital loss was incurred.

It is a fact that Engineers still retains 162,612 shares of common stock of Virginia Electric & Power Company.[85] If this stock is disposed of prior to December 31, 1949, any profit realized above the tax cost would be subject to a capital gains tax of 25 percent, but this could be in turn offset against the capital loss of approximately $23,000,000 remaining from the Puget Sound transaction, a further tax advantage for the common stockholders.

At page 98 of the Central-Illinois Brief, the following statement appears:

> "It is evident that if appropriate account is taken merely of the changes which have already occurred, even on the Commission's valuation formula the preferred stockholders could not be found entitled to more than $100 per share."

This statement is obviously incorrect and is predicated only upon opinion of counsel, based upon the so-called statistics.

At page 101 appears a rather bizarre contention, predicated upon using the total dividends normally payable to the preferred and employing this as a numerator and taking the *earnings* of Virginia, El Paso and Gulf States for 1947 as the denominator, and then allocating, on the basis of this fraction, 20

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[85] H. C. A. R. No. 8631 (1948).

percent of the total assets, to the preferred stockholders, in payment of their claim. Magnanimously the Central-Illinois brief suggests awarding an additional 5 percent for the preferred "loss of position" making a total of 25 percent for the preferred. It is concluded from this that the preferred current cash value approximated $70 per share. If this "reasoning" were to be followed, it is apparent that the worse position a holding company was in, the higher percentage, up to 100, would the preferred get. In other words, if the earnings were high and the preferred dividend requirements are low, it would amount to the common stockholders paying the preferred out, with such percentage of the earnings of the system, as the annual dividend requirements of the preferred, bore to such earnings. We cannot recognize that this contention is advanced seriously. In addition to the utterly ridiculous character of it, it completely overlooks the fact of the preferred's priority. The same conclusions may be addresesd to the equally specious calculation in footnote 3 appearing at pages 101-102 of the Central-Illinois brief. There, applying the same 25 percent figure to the total estimated market value of the underlying securities, Central-Illinois concludes that the preferred would only be worth approximately $66 each. Such a calculation merits no reply.

On page 106, it is stated that the District Court "appraised" the proposed payment to the preferred stockholders both "intra the Act" and "ex the Act." How, we ask, did the District Court arrive at the amount of $100? What "method of appraisal" was applied to reach a result giving all three series of preferred stock having different interests rates the same amount, to wit, $100 per share? What equity

is there in that? What factors were decisive? How did he appraise the preferred *ex* the Act and *intra* the Act? Baldly stated, the District Court Judge felt that $100 was "enough". It is clear that his "valuation", regardless of the expressions in his opinion, went no deeper than that.

At page 112 is another "calculation" by counsel for the Central-Illinois Company predicated upon the assumption that in the supposed situation the senior securities might receive an amount which might wipe out the equity of common stockholders. In the suppostitious case, it is suggested that the common stockholders would propose a plan to eliminate themselves entirely from either the enterprise or any equity therein. This is, of course, absurd. The hypothetical case suggests one in which the *Otis* principle would unquestionably be applied both by the common stockholders and by the Commission and the courts. It must never be overlooked that the decision as to the plan and its method of effectuation, rest entirely with the common stockholders.

At pages 118 and 119 there appear many statistics concerning the El Paso Natural Gas Company and the divestment of Engineers interest in this company is characterized as an additional hardship. The Commission in its main brief, at p. 63, *et seq.* have completely answered this erroneous contention.

There are other portions of Central-Illinois's Brief in which its counsel engage in calculations and hypothetical conclusions, interpersed freely with opinions of investment values. It is clear that all of the financial data are designed to discredit the Commission's valuation or point in the direction of alleged changed circumstances, although it is nowhere asserted that the change is so radical as to require a reopening.

The references to changed money rates and the rise and decline of stock market prices, appear to lack merit in the light of the facts considered by the Commission and the corroboration to be found in the events of the three years following the Commission's decision, as evidenced by complete failure on the part of Central-Illinois to adduce any contention to the contrary. Money rates may go up and they may go down. Market prices have been up and have gone down and may go up again. Both may fluctuate either one way or the other, but nothing has happened in the past three years to shake in the slightest degree, the soundness of the Commission's conclusions, on the problem of valuation.

IV. Concerning the contention as to the Commission's alleged failure to value on the basis of a continuing enterprise.

As demonstrated above, the various factual hypotheses upon which Central-Illinois bases its contentions are erroneous. Moreover, the principles and techniques of valuation which it urges are equally inapplicable and incorrect. Rather than restate at length the applicable principles and methods, we respectfully refer this Court to our original Brief (p. 105 ff.). However, we cannot let pass unnoticed, several erroneous contentions, but do not, by our silence, as to others, intend an acceptance of the Central-Illinois views.

A. Central-Illinois criticism that the Commission's determination of investment value merely represented momentary "transient market values"[86] is a complete distortion of the record. As shown above (p. 4),

[86] Central-Illinois Brief, p. 73 ff.

a variety of factors such as earning power, dividend record, history of company, asset coverage, etc., all of which criteria provide a proper basis of valuation,[87] were considered. The absence of definition[88] (although to be sure the Commission had Dr. Badger's definition before it) is inconsequential as long as all the requisite elements of value are considered, as they were by the Commission. There is little in the label. In short, the content or its characteristics, and not the label, are important. Furthermore, reference to *Schwabacher* v. *U. S.*, 334 U. S. 182 (1948), which involves an analogous problem of valuation, also discloses the use of a variety of combinations of the similar phrases by this Court, *i. e.*, "the present intrinsic values", "current worth", "present intrinsic or market value", "current values", "intrinsic or market values" and "intrinsic value". It is clear from the *Schwabacher* case that this Court measured the "intrinsic value" in terms of the "stock's past yield, present market value, and future prospects" (334 U. S. 200), all of which were considered by the Commission in the instant case. Consequently the Central-Illinois contention is merely an "exercise in semantics" and is wholly devoid of merit.

B. Central-Illinois also seeks to show the Commission's variance from the doctrine of equitable equivalents by an alleged measurement of preferred stockholders' rights by use of "momentary market price".[89] This contention is obviously lacking in merit, as the Commission made its valuation on the basis of appro-

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[87] *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 526 (1941).

[88] See definition of fair investment value, by Dr. Badger, *supra*, p. 4.

[89] Central-Illinois Brief, p. 86 ff.

priate and relevant economic data, as indicated above, and did not rely primarily upon the isolated so-called "transient values" as Central-Illinois contends. The facts speak for themselves, but not as stated by Central-Illinois.

Citing the *DuBois*[90] and *Group of Institutional Investors*[91] cases, Ceneral-Illinois makes this interesting observation:

> "It is fundamental that in valuation for reorganization purposes earning power and other relevant economic factors must be calculated *prospectively* on a normal going-concern basis, with due regard of the past" (Central-Illinois Brief, p. 86).

Then Central-Illinois stresses the phrase "investment value" as employed by this Court as connoting "values on a long range basis of both classes of stockholders predicated upon their relative rights to participate in the prospective earnings of the enterprise".

The record clearly indicates that Dr. Badger did consider and prognosticate on the future of the three underlying operating companies of Engineers (R. 2103a). Furthermore, it is clear that the common insisted upon having distributed to it all of the stock in these three underlying companies. It is our position that consideration was given to prospective earnings of the three subsidiaries by Dr. Badger. On the other hand, in view of the determination of the common stockholders to secure the advantage of these three operating companies for themselves, it is quite obvious

90 *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510 (1941).

91 *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. R. Co.*, 318 U. S. 523 (1943).

that they were satisfied that any long range forecast of prospective earnings was surplusage.

In place of the so-called "values on a long range basis" and prospective "earning power", as urged by Central-Illinois, the District Court verbalizes on the "colloquial" equities, or various nonvaluation criteria, the error of which we have already shown.[92] Yet at the same time, Central-Illinois apparently finds no fault with the Circuit Court's instruction "to ascertain the future earning power of the system" and "to apportion earning power between the preferreds and common based upon their respective claims to income" (R. 35). As the Circuit Court relies upon the same cases cited by Central-Illinois, the only error which Central-Illinois finds in the opinion of the court below is the direction for remand, implying in effect, that the two courts had applied the same principles of valuation. At this point, Central-Illinois counsel finds himself figuratively standing astride two horses pulling in diametrically opposite directions. Central-Illinois counsel provide an "apt solution" for this predicament by the introduction of their own "expert valuation" to overcome the divergent tugs. Thus a simple reconciliation is attempted between the two opinions below by means of numerous references to statistical data and arguments of counsel flowing therefrom, to show that the preferred could not get more than $100 in any event. Such expedient cannot sustain the basically inconsistent position that Central-Illinois has taken, even after the vain attempt to augment the District Court's findings. We contend as previously set forth, that both courts below erred. The standard of "colloquial equity", as enunciated by

92. Streeter Brief, p. 113 ff.

the District Court, and as approved by the court below *sub nomine* "substantial equities", substitutes nebulous nonvaluation criteria for definite contract rights of security holders and results in a shift in emphasis, from such primary factors as current rights to earnings and assets, as proclaimed in the *Otis* and *Schwabacher* cases.[93] Furthermore, the criticism of the court below, levelled at the Commission, for its failure to give substantial consideration to future earning power and ascertain and apportion it between the preferreds and the common (R. 35) is unwarranted, for the reasons as pointed out in our Brief.[94] The instant situation is materially different from that in the *Otis, DuBois* and *Group of Institutional Investors* cases ~~and~~, as recognized in the *DuBois* case, the *facts* of each case determine the extent and method of inquiry necessary for valuation, based upon earning capacity. In the instant case, where past, present and estimated earnings (R. 1826a) were considered, and careful study discloses an amplitude of earnings coverage for the preferred, to which the common's claims are subordinate, and the available cash is not required for use to meet the dividend and interest requirements of flourishing operating subsidiaries (there being no interest or dividend arrearages), a hypothetical projection of earning capacity, far into the future, it is urged, is unnecessary, and, in any event, speculative. As valuation for simplification purposes requires an appraisal of many factors which cannot be reduced to a fixed formula and entails a prediction of future events, "an estimate, as distinguished from mathe-

[93] Streeter Brief, p. 113 ff., 124.
[94] Streeter Brief, p. 132 ff.

matical certitude, is all that can be made". *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. R. Co.*, 318 U. S. 523, 542 (1943).

Central-Illinois also cites a series of cases (at pp. 89-91) suggesting that the Commission found valuation for the preferred in the instant case, based only on market prices, despite the fact that even in the matters quoted in the footnote the Commission has expressly negated any such policy. Those calculations of the preferreds' claims on the basis of "market prices" are irrelevant, as that criterion does not in fact, reflect the valuation technique used by the Commission. Furthermore, it should be noted that the various cases cited by Central-Illinois, in which the preferred claims were measured against future earning power, are to be distinguished from the instant case since they involve situations similar to the *Otis, DuBois* and *Group of Institutional Investors* cases.[95] Likewise, *Georgia Power & Light Co.*, H. C. A. R. No. 5568 (1945), enforced Civil Action No. 133 (M. D. Ga., 1945), cited by Central-Illinois (at pp. 93-4), is also similar to the *Otis* case in that dividend arrearages of the preferred, there involved, had to be valued, in order to insure fair and equitable treatment to the preferred. The fact that the *Georgia Power & Light Co.* case involved a projection of earnings for the purpose of valuing the preferred dividend arrearages is completely disregarded by Central-Illinois. Moreover, reference to the opinion discloses that no apportionment of the earning capacity was made. Under such circumstances the valuation technique in the two cases is reconcilable, since in both cases no apportionment was made, while a forecast was required in the

[95] See discussion, Streeter Brief, pp. 132-4.

Georgia Power & Light Co. case because of the dividend arrearages. In the instant case as there were no dividend arrearages and because the Commission and the common stockholders were, no doubt, completely satisfied with the future prospects of the three operating subsidiaries, no such claim was made either on behalf of Engineers or the common stockholders. Moreover, in *National Power & Light Company*, H. C. A. R. No. 8445 (1948), and *Pennsylvania Edison Co.*, H. C. A. R. No. 8550 (1948), short term forecast of future earnings (3-4 years) was made for certain specific purposes (*i. e.*, ability to meet dividend requirements, etc.), but in neither was any apportionment of earning capacity necessary. Likewise in the instant case, the Badger forecast was supplemented by a prediction as to the future earnings course of the underlying companies. There is virtually nothing in the Central-Illinois Brief, except references to the decline in market price of securities, changed money rates, etc., which in any way suggests that Dr. Badger's predictions were unjustified.[96] It should also be noted that although the equitable equivalent must be received regardless of the type of distribution—cash or kind—the valuation technique may be affected by such factors, either separately or combined, *i. e.*, the type of distribution, the existence of dividend arrearages, nature of the simplification (formation of a new company, recapitalization of the old, dissolution), the integrity and practicability of the new capital structure, and the propriety of junior security participation. As

[96] The Central-Illinois reference (Brief, p. 95, n. 1) to decline in earnings of Virginia has been answered at p. 60, *supra*. We, of course, believe that all such data, subsequent to the consummation of the plan are entirely irrelevant.

indicated above, the facts determine the nature and method of the valuation process. For the situation at hand, the requisite criteria, such as actual and estimated earning (with a prediction as to the future), dividend and earning records, asset coverage, etc. provided a proper basis for the valuation by the Commission.

C. We have already[97] demonstrated lack of merit in the criticism of the court below, which is also urged by Central-Illinois,[98] that the Commission allegedly adopted inconsistent techniques in valuing the preferred "*ex* the Act" and the common "*intra* the Act". In passing, however, it is appropriate to note our disagreement with the Central-Illinois assertion that the phrase "residual" claimants implies a "liquidation". On the contrary, an ordinary meaning of the word "residual" is "that which remains after subtraction".[99] In fact, that is the nature of the reciprocal valuation applied in the instant case. In other words, the Commission valued the preferreds on a going concern basis, and subtracted that value from the total enterprise (of which the preferreds and the common were the two claimants) with the result that the remainder went to the residual claimants, the common, as demanded by them. This reciprocal valuation which involved a dollar value for the preferred and the residuum for the common stock, results in findings of value for both the preferred and the common. Consequently, the criticism of the court below as to the

[97] Streeter Brief, p. 128 ff.

[98] Central-Illinois Brief, p. 103 ff.

[99] Funk & Wagnalls *New Standard Dictionary of the English Language* (1935), vol. 2, p. 2092.

absence of a finding of value for the common is without merit.[100]

The Commission, in determining the participation of the preferred, under the fair and equitable standard, on the basis of its intrinsic value did not ignore the rights of the common. It viewed the common as a residual security by its nature, in accordance with the terms of the contract, which created the priorities and made its rights subordinate. Despite the charge of the District Court in which Central-Illinois has joined,[101] that the Commission was "dealing cards off the top of a deck" (R. 291a), the Commission merely applied the doctrine of full priority, as incorporated in the fair and equitable standard.[102] Moreover, the Commission had not overlooked the rights of the common, but found the plan of immediate benefit to the common and fair to them (R. 69a).

V. Concerning the Contention as to Alleged Repugnancy of the Fair Investment Value, to the Strict Priority Principle and the Fair and Equitable Standard.

We have pointed out above (*supra*, p. 26) the fallacy of the Central-Illinois contention (Brief, p. 108) that the bankruptcy and equity receivership reorganization precedents do not support payments to senior security holders "in excess of their contract claims". First, no excess over the preferred contract

[100] Streeter Brief, pp. 130-132.

In this connection Central-Illinois again finds itself in the unhappy plight of supporting the inconsistent views of both courts below: the Circuit Court criticizing the Commission for its failure to make a finding of value for the common and the District Court finding no fault on this score with the Commission's action. Central-Illinois sidesteps the issue.

[101] Central-Illinois Brief, p. 105.

[102] *Otis & Co. v. S. E. C.*, 323 U. S. 624 (1945).

claim is sought, but the equitable equivalent thereof. Second, bankruptcy or equity receiverships mature liquidation preferences, which consequently become the conclusive measure of the security holders rights, while in the instant case, the simplification did *not* mature the preferreds' claim and hence required the ascertainment of the amount to be received by the preferred, by a valuation of the rights surrendered, on a going concern basis. Thus, in the *Otis* case, this Court points out that the fair and equitable standard of section 11(e) incorporates the principle of full priority, in the treatment to be accorded various classes of security interests, and then indicates the need to recognize prior rights to earnings and assets in the following language:

> "* * * When by contract as evidenced by charter provisions *one class of stockholders is superior to another in its claim against earnings or assets that superior position must be recognized* by courts or agencies which deal with the earnings or assets of such a company. Fairness and equity require this conclusion. * * * This is the rule applied by the Commission in the simplification of corporate structure. The Commission recognizes and applies the doctrine of full priority by giving value to the rights of the preferred *in a going concern rather than as if by sale and distribution* * * *" (323 U. S. 634-5). (Italics ours.)

That superior position of the preferred must, under the mandate of the *Otis* case, be recognized on a going concern basis, not as urged by Central-Illinois, on a "liquidation" basis.

The investment value doctrine, as previously indicated,[103] connotes no fictional device, but signifies the

[103] Streeter Brief, p. 136.

measure of the bundle of rights surrendered—the end result of the valuation process, reflecting earning power, market history, dividend record, asset and earning coverages, priorities and other revelant factors,[104] all of which were considered by the Commission, and not "momentary peak market prices" as Central-Illinois implies. The reciprocal valuation protects both the common and the preferred. An over all dollar valuation or a dollar valuation for the common, suggested by Central-Illinois (Cf. Brief, p. 113) is not required and would merely create an illusion of certainty where none exists.[105]

VI. Concerning the Contention as to the Alleged Imposition of Supposed Additional Losses.

A. "Frustration" v. "Appropriation".

Baldly stated, Central-Illinois contends that the "deprivation" sustained by the prefered stockholders upon the compulsory retirement of their stock, by the payment of $100 per share, is not compensable and that the common stockholders did not "necessarily" become the beneficiaries thereof. In other words, the argument is that the contract has been frustrated by governmental action and therefore the preferred stockholders are not to be compensated for the valuable

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104 *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 526 (1941).

105 *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 486-8 (1943); *Group of Institutional Investors* v. *Chicago, Milwaukee, So. P. & P. R. R. Co.*, 318 U. S. 523, 564-566 (1943). In the latter case this Court in referring to the issue of compensatory treatment, comments as follows: "A decision on that issue involves a consideration of the numerous *investment features* of the old and new securities and a financial analysis of many factors" (318 U. S. 571). (Italics ours.)

rights surrendered. In support of this contention, Central-Illinois cites *U. S. ex rel. T. V. A. v. Powelson*, 319 U. S. 266 (1943). At the outset, it must be observed that the elimination of the preferred results from the conscious deliberate decision of the common stock management, and need not have occured, despite the Act, but for that decision. It cannot be asserted that the retirement of the preferred was occasioned *solely* by the sovereign act of the government. Clearly distinguishable from the instant situation is the *Powelson* case, which involves the exercise of the power of eminent domain by the T. V. A. and is wholly unrelated to the problem of respective rights of security holders on simplification under the Act. Thus in *The North American Co.* v. *S. E. C.*, 133 F. (2d) 148, 154 (C. C. A. 2, 1943), aff'd 327 U. S. 686 (1946), it was pointed out that "Compelling the holding company to dispose of its securities is not the same as condemning private property for public use without paying just compensation". Moreover, the *Powelson* case clearly recognizes that compensation must be made for the appropriation of a "going enterprise" (319 U. S. 282). It is also clear that the preferred stockholders must receive "just compensation" for their interest, or their ~~equitable~~ equivalents in accordance with the due process requirements.[106] Despite the Central-Illinois claim, the Commission has not confused "'frustration with appropriation'". On the contrary, as pointed out above (p. 43 ff.) the Commission must have recognized the difference and correctly refused to apply the doctrine of frustration in the determination of the rights of security holders in a simplification under the Act. To have limited the

[106] *American Power & Light Company* v. *S. E. C.*, 329 U. S. 90 (1946); *The North American Company* v. *S. E. C.*, 327 U. S. 686 (1946).

preferred stockholders to the involuntary liquidation amount on the Central-Illinois theory, would have resulted in an "*appropriation*" of their rights for the benefit of the *common*, without compensation. Such treatment is forbidden by the principles of *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510 (1941), that full compensatory provision must be made for the bundle of rights surrendered. As stated by this Court:

> "* * * If they [creditors] receive less than that full compensatory treatment, some of their property rights will be *appropriated* for the benefit of stockholders without compensation. That is not permissible. The plan then comes within judicial denunciation because it does not recognize the creditors' 'equitable rights to be preferred to stockholders against the full value of all property belonging to the debtor corporation'." (312 U. S. 529).[107]

"In concrete terms", we contend and the Commission has held that the preferreds are entitled to the current going concern value of the bundle of rights (including *inter alia*, the prior rights to earnings) surrendered, namely, an amount at least equal to the redemption prices, and that to the extent that they receive less, the common will have profited.

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107 *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. R. Co.*, 318 U. S. 523, 570 (1943). In the latter case this pertinent observation is made: "Unless that principle [of full priority] is respected, there will be serious invasions of the rights of senior claimants to the benefit of junior interests. The property of one group will be subtly appropriated to pay the claims of another while lip service is rendered the principles of priority."

B. Alleged "Frivolous Claim" of "Economic Benefit to the Common Stockholders".

The contention as to the absence of "economic benefit to the common" is not borne out by the record. It has been indicated elsewhere that the earnings and assets of Engineers had increased during the process of divestment (*supra,* at p. 20). It was also pointed out how the Puget Sound burden was eliminated, and how Engineers used a portion of its assets to acquire Virginia Public Service Co., merging it into Virginia and thereby materially increasing its underlying assets and earnings. Tax benefits have flowed to the common stockholders in the form of capital appreciation taxable at 25%, instead of ordinary income taxable at higher rates. *The common have obtained the direct ownership of three flourishing underlying operating companies by their exclusion of the preferreds.* The warrant program, erroneously labeled as a "special assessment", has provided the common stockholders with a benefit of $3-4 per share and an increase in earnings of $1.08 per ashare. Pertinent to the elimination of the preferred from the enterprise, is the following observation of the Commission:

> "* * * Under the circumstances the elimination of this prior charge is highly beneficial to the common. Moreover, in so far as the retirement of the preferred is a step toward bringing the Engineers system into complaince with the Act, it *hastens the day when the common will begin receiving dividend income*" (R. 69a). (Italics ours.)

It is no wonder that the Commission found, and rightly so, that the elimination of the preferred stock was of immediate benefit to the common (R. 69a). The characterization as "frivolous" is but a resort to adjective instead of fact.

PART THREE.

The Function of the Section 11(e) Court and the Direction for Remand.

VII. As to Contentions Whether the District Court Exceeded Its Power in Rejecting the Commission's Determination of Fairness.

Point I of the Streeter brief not only establishes the fallacy of the Central-Illinois contention on this score, but also clearly demonstrates the error in the views of the two courts below as to the power of the 11(e) court, to ignore the Commission's findings and determination of fairness and value, even though based upon substantial evidence and possessing warrant in the law and in the record. In that connection, we have shown that the District Court does not have the power to reject such findings and determination of the Commission, on the basis of its own discretionary weighing of so-called colloquial equities and in disregard of the doctrines of substantial evidence and administrative finality. That concept, as to the limitation upon the scope of review by the 11(e) court in passing upon the fairness of a plan, is borne out by the provisions of the Act, is consistent with the legislative history and analogous precedents in the law of reorganizations (Streeter Brief, p. 29 ff.), recognizes the correlation between sections 11(e) and 24(a) as alternate avenues of reviews (*Id.*, p. 68 ff.) and accords with the preponderant judicial authorities in deciding the issue (*Id.*, p. 77 ff.) under the Act and with decisional and statutory trends in administrative law (*Id.*, p. 90 ff.). The course of that discussion

indicates the lack of merit in the respondent's present contention. Rather than repeat our argument, we shall comment on various erroneous and unmeritorious contentions of Central-Illinois.

1. The Central-Illinois group formerly asserted that "the 'essence of the holdings of both Courts below was that the Commission's *conclusions* are without substantial evidentiary or legal basis; or, stated, in the restrictive terms for which Petitioners contend, that they 'lack rational or statutory foundation' ".[108] Now at last Central-Illinois counsel admits that the court below refused to apply the doctrines of administrative finality and substantial evidence (p. 124) (which refusal, we maintain is erroneous), and contends, nevertheless, that "even under the most restrictive view of the jurisdiction of the District Court in these matters, its judgment * * * was correct and should be affirmed since the conclusion of the Commission" as to the fairness of the plan was without "rational and statutory foundation".[109] In the first place, this contention is clearly contrary to the reasoning and approach of the District Court. No elaborate discussion is required to demonstrate that the District Court erroneously ignored the Commission's findings of fairness, mistakenly substituted its own determination for that of the Commission, in disregard of the doctrines of administrative finality and substantial evidence, made its own "valuation" of $100 per share of the preferred stock, amended the plan to that extent and enforced the plan, as so amended by it.[110] In fact, to the extent that the District Court substituted its valuation for that of

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[108] Sic. Central-Illinois Brief in Opposition to Petitions, p. 9.
[109] Central-Illinois Brief, p. 125.
[110] Streeter Brief, p. 76 ff.; p. 154 ff.

the Commission and enforced the plan as amended by it, the court below concluded that the District Court erred (R. 39), with which conclusion we agree, assuming, *arguendo,* that the District Court's disapproval of the plan for unfairness was correct.[111] In the second place, even further assuming *arguendo* that the District Court had tested the Commission's conclusion of fairness, on the basis of the doctrines of substantial evidence and administrative finality, and had determined that the Commission's conclusion of fairness lacked rational and statutory foundation or that the Commission had plainly abused its discretion (both of which we dispute), then it would have been the duty of the District Court to reject the Commission's conclusion or reverse its judgment and remand to the Commission for a fresh determination. But in that event, the District Court, should not, as it did, enter its own judgment as to the fairness of the payment of only \$100 per share to the preferred stockholders of all three series (R. 288a, n. 2, 320a). In effect, Central-Illinois seeks to distort the application of the doctrine of administrative finality by seeking to obtain the affirmance of the District Court's "independent" valuation of the preferreds' participation at the same time resisting any remand to the Commission. We have shown in our brief,[112] and the record clearly demonstrates that the Commission's findings and conclusion should have been sustained, since based upon substantial evidence and possessing rational and statutory foundation. In fact, even under the approach of the court below, the Commission's determination was not arbitrary or capricious

[111] This assumption we have challenged in Point III of our brief and demonstrated it to be erroneous.

[112] Streeter Brief, Point III-C, p. 142 ff.

and should have been upheld. Lastly, underlying this contention of the Central-Illinois group are statements that the District Court, in reaching its determination of unfairness "was not required to disturb, and did not disturb, any factual finding of the Commission" and that the "District Court differed with the Commission's ultimate conclusion, based upon the admitted and undisputed facts as set forth in the Court's opinion and findings".[113] These Central-Illinois statements, like the former assertions that the conflict between the District Court and the Commission relates primarily to legal conclusions and not the factual findings of the Commission[114] clearly contradict the District Court's definite rejection of "such findings and conclusions of the Commission [that] relate to or bear upon the payments of the premiums or are inconsistent with the Opinion dated May 15, 1947 or with the findings and conclusions of law filed with said Order" (R. 293a-294a).[115] Likewise the Central-Illinois effort to attribute accuracy to "the facts recited in the District Court's opinion or in its findings"[116] by virtue of the alleged absence of attack thereon is unavailing. The record is clear that Central-Illinois counsel at the suggestion of the District Court prepared the findings allegedly based upon the record

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113 Central-Illinois Brief, p. 125.

114 Central-Illinois Brief in Opposition to Petitions, p. 9.

115 It can hardly be fairly claimed that the District Court's findings Nos. 36-38 (R. 307a-308a) are consistent with the Commission's findings (R. 69a-72a). The failure to recognize the conflict between the District Court's and Commission's findings is surprising as Central-Illinois counsel apparently prepared the findings for the District Judge (R. 377a, 385a).

116 Central-Illinois Brief, p. 125. In fact, Central-Illinois counsel even opposed a hearing on the proposed findings (to no avail) as "it would be a rehearing of the entire case" and pointed out that the District Judge could satisfy himself on the basis of his annotation of the findings to the record (R. 368a).

before the Commission for signature by the District Judge (R. 368a). Some of these findings are consistent with and others inconsistent with the Commission's findings. One glaring factual difference[117] between

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[117] Central-Illinois at several points seeks to cloak with finality certain allegedly concurrent findings of the two courts below on the basis of the principle recently reaffirmed in *Comstock* v. *Institutional Investors*, 335 U. S. 211, 214 (1948) that a "seasoned and wise rule of this Court makes concurrent findings of two courts below final here in the absence of very exceptional showing of error". It is obvious that the instant situation is far different from that in the *Comstock* case as is clearly revealed in the opening recital of this Court's opinion in that case quoted as follows:

> "The issues of facts, contested in a long hearing, are not before us for review. Petitioner assured us, in support of the petition for certiorari here, that 'there is no factual controversy before this Court' and 'we assume the findings of the District Court. Our challenge is directed only to the legal import of these unchallenged facts.'"

Examination of the opinion in the *Comstock* case discloses unchallenged findings as to a basic issue of good faith which had never been raised before the Interstate Commerce Commission (such procedure of bypassing the Commission, according to this Court, is not to be encouraged).

In the instant case on the basis of the rule as to concurrent findings, Central-Illinois claims finality for the District Court's findings as to losses arising out of divestments occasioned by the Act (p. 61, n. 1), and the "examination of relevant factors" (p. 125, n. 1), both supposedly affirmed by the court below. In the first place, there is a clear-cut conflict between the District Court and the Commission with respect to the cause of these losses as contrasted with the *Comstock* case where the basic finding as to which the two courts were in agreement, was unchallenged. In the second place, the court below, although sustaining the District Court's examination of the various factors, expressly refused to permit the District Court to substitute its valuation of $100 for that of the Commission. Furthermore, the rule of concurrent findings was clearly not intended to permit a disregard of the factual findings of the trier of facts, that is, the Commission, and none of the decisions cited by this Court in the *Comstock* case indicate such application of the rule. Rather has this Court on occasion sought to protect the findings of an administrative body by the application of this very same rule. *E. g.*, *Columbus*

[Footnote continued on following page.]

the views of the District Court and those of the Commission, is the treatment of the alleged losses from divestments. While the Commission refused to accept the hypothesis "that the Act has caused the asserted losses" (R. 72a, n. 55), the District Court found that the "losses" arising from the divestments were occasioned by the Act (Findings Nos. 37-8, R. 307a, 308a).[118]

[Footnote continued from preceding page.]

Gas & Fuel Co. v. *Public Utilities Commission*, 292 U. S. 398, 414 (1934). In any event, "it is not a rule to be applied in a blind manner simply because a case involves a complex factual situation" as is aptly pointed out in the dissenting opinion in the *Comstock* case. Assuming arguendo, that there are concurrent findings that fall within that rule, it is here urged that "there is an exceptional error involved in the conclusions reached by the District Court and affirmed by the Circuit Court of Appeals, an error that is apparent on the face of the District Court's findings". In this connection, it should also be noted that the following status is attributed to the findings of the court under Rule 52(b) of the Federal Rules of Civil Procedure:

> "* * * When findings of fact are made in actions tried by the court without a jury, the question of the sufficiency of the evidence to support the findings may thereafter be raised whether or not the party raising the question has made in the district court an objection to such findings or has made a motion to amend them or a motion for judgment."

118 Counsel for Engineers recognized the difference between its assertion and the Commission's views when he wrote:

> "The principal findings of fact involved therein we think have to do with * * * (2) the losses which Engineers claimed were suffered from the impact of Section 11 of the Act.
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> "As to (2) above, it will be recalled that Engineers claimed certain losses which should equitably be borne by the preferred as well as the common. These included, among others, losses resulting from the forced sale of Puget Sound and El Paso Natural Gas, and that resulting from the fact that the impact of the Act had prevented the Company from refunding the preferred stock with its present relatively

[Footnote continued on following page.]

There is no need to multiply the examples of differences in the factual findings of the District Court and the Commission. The Central-Illinois effort to secure the review by this Court of the rational and statutory foundation of the Commission's decision in the light of the *findings* of the District Court, instead of the Commission's findings, must be rejected, since the premise as to the acceptance by the District Court of the Commission's findings (and vice-versa), upon which the Central-Illinois contention is based, lacks factual basis and is fallacious.

2. Central-Illinois counsel also *cautiously*[119] suggests that "the court below was perhaps overstating the effect" of *Lahti* v. *New England Power Ass'n.*, 160 F. (2d) 845 (C. C. A. 1, 1947), and *Mass. Mutual Life Ins. Co.* v. *S. E. C.*, 151 F. (2d) 424 (C. C. A. 8, 1945), cert. den. 327 U. S. 795 (1946), in referring

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[Footnote continued from preceding page.]

high dividend rates on the basis of the lower dividend rates for comparable securities now prevailing (For details as to these claimed losses see pp. 12-15 of Engineers' brief). In order to sustain Engineers' claim respecting these losses, it is important that these losses be recognized and found to have been caused by the Act. Not only does the Commission not find that these losses were caused by the Act, but in footnote 52, [55] above quoted, they say they do not 'accept counsel's hypothesis that the *Act* that [has] caused the asserted losses'. It is not improbable that a reviewing court might say this was tantamount to a finding that the losses were not caused by the Act so directly, at least, as to be used as an offset to the payment of the premiums to the preferred stock" (R. 1953a-1954a).

The bracketed references are based upon the footnote as printed elsewhere in the record (R. 72a, n. 55).

119 The Central-Illinois group in its Brief in Opposition to the Petitions at p. 13, n. 18, originally sought to discredit the recognition by the court below that the cited decisions "look the other way" as not based upon "an independent analysis of the decisions themselves".

to them "as 'cases which look the other way, and [which] are entitled to great consideration'".[120] Rather is the view of the court below an understatement, as examination of the *Lahti* and *Massachusetts Mutual* cases[121] will reveal a clear-cut conflict with the opinion below in the instant case and the recognition and application of those cases of the doctrines of substantial evidence and administrative finality, which represent the views of the majority of appellate and lower courts on this question.[122]

One of the respondents (White) may urge as a distinction that, in the instant case, the court below, in its review, considered the "function of the District Court *vis-a-vis* the Commission" while in the *Lahti* and *Massachusetts Mutual* cases, the "Circuit Court was acting only as a review court and was bound by the findings of fact of both the District Court and the Commission".[123] The attempted distinction is devoid of merit. In both the case at bar and the *Lahti* and *Massachusetts Mutual* cases, the status of the Commission's findings or the treatment to be accorded them by a section 11(e) district court was at stake, and consequently affected the relative function of the district court and the Commission. Reference to the opinions of the respective District and Circuit Courts in these cases confirms the fact that the standard to be used by a section 11(e) court in reviewing the Commission's action, was involved, and that the First and Eighth Circuit Courts, contrary to the Third Circuit, adhere to the view that the Commission's findings and

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120 Central-Illinois Brief, p. 142.

121 The *Lahti* and *Mass. Mutual* cases are discussed in the Streeter Brief, p. 82 ff.

122 Streeter Brief, p. 76, n. 100.

123 See White Memorandum in Opposition to Petitions, p. 15.

determination must not be upset if supported by substantial evidence or unless shown to be without rational basis in fact and law.[124] Moreover, any doubt that the function of the District Court was in issue in the *Massachusetts Mutual* case[125] was recently removed by the decision of *In re Northern States Power Company*, 80 F. Supp. 193 (D. Minn., 1948). In the latter case, the District Judge recited the unsuccessful contentions of appellant in the *Massachusetts Mutual* case, as to the District Court's abdication of its independent duty and its acceptance of the Commission's conclusion[126] and commented that "the weight, therefore, that the court should attach to the Commission's factual findings was directly before the Circuit Court in that [*Massachusetts Mutual*] case" (80 F. Supp. 201). Furthermore, the recent decisions of the District Courts within the First and Eighth Circuits have adhered to the standards enunciated within their respective Circuits and refused to follow the decision of the Third Circuit in the instant case. *In re Northern States Power Company*, 80 F. Supp. 193 (D. Minn.,

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124 Streeter Brief, p. 76 ff.

125 The *Massachusetts Mutual* case is discussed in Streeter Brief, p. 82.

126 In the *Northern States Power Company* case, the District Judge recited the contentions unsuccessfully urged in the *Massachusetts Mutual* case as follows:

> "'Section 11(e) of the Public Utility Holding Company Act of 1935 requires the District Court to independently determine whether the plan is fair and equitable and appropriate to effectuate the provisions of Section 11 of the Act. The Court cannot, as it has done here, abdicate this independent duty to the Securities and Exchange Commission.'
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> "'The Court below failed to exercise the independent judgment required of it by the Act. Instead it completely accepted, and felt itself bound by, the conclusions of the Commission, which at best are advisory only'" (80 F. Supp. 201).

1948); *In re American and Foreign Power Company*, 80 F. Supp. 514, 522 (D. Me., 1948). In fact, in the *Northern States Power Company* case, the District Judge refused to reject the Commission's valuations and factual findings, since supported by substantial evidence and recognized the soundness of the "rational basis" rule of the Eighth Circuit. The views expressed in the *Northern States Power Company* case, were approved in the *American and Foreign Power Company* case, *supra*. Consequently, under the prevailing view, the section 11(e) court is required to accept (and not ignore) findings and determinations of the Commission, if based upon substantial evidence and having a rational basis in fact and predicated on no clear-cut error of law.[127] Under the majority doctrine, it is clear that a district court's rejection of the Commission's conclusion as to fairness, in disregard of the principles of substantial evidence and administrative finality would constitute reversible error. So, too, in the instant case, we urge that the court below committed error in sustaining the District Court's rejection of the Commission's conclusion as to fairness, where supported by substantial evidence and possessing rational and statutory foundation.

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[127] The disagreement in conclusion between the District Court and the Commission is attributable in part to the application of an erroneous standard by the District Court, for the review of the administration action. Moreover the difference in the standards of review as between the Third Circuit and the other circuits (First, Second and Eighth) is so substantial as to result in a disapproval of the Commission's decision on a section 11(e) plan in the Third Circuit, and its approval in the First, Second and Eighth Circuits.

VIII. Concerning the Contentions as to Remand.

We have already disposed of the Central-Illinois contentions,[128] opposing a remand to the Commission, in our brief.[129] The gist of our position briefly stated is that assuming *arguendo*, that the Commission erred in its valuation of the preferred stockholder's interest, the District Court did not, as the court below correctly found, have the power to amend the plan and substitute its valuation for that of the Commission, but is required to remand to the Commission for its initial determination.

Although our brief adequately answers the Central-Illinois contentions, for the convenience of this Court, we wish to point out the absurdity of the statement in the Central-Illinois brief which describes the District Court's determination as follows:

> "* * * The District Judge *did not determine that the Commission must award a specific sum to the preferred stockholders;* nor has it ruled that while the Commission might fairly and equitably award more than $100 to the preferred, a maximum of $100 was also 'fair and equitable' and in its judgment sufficient. In either of those cases it might be contended that the District Court was intruding upon the Commission's legitimate function under the Act. But here the Court has decided only that the Commission could not lawfully award more than $100; *i. e.*, it has examined the record made before the Commission in order to determine the outer limits of permissible Commission action on that record, and concluded that

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[128] Central-Illinois Brief, p. 148 ff.

[129] Streeter Brief, p. 154 ff.

no more than $100 can 'fairly and equitably' be paid to the preferreds" (pp. 155-6). (Italics ours.)

In juxtaposition, we set forth the following language in the District Court's opinion:

"It is, of course, true that once the charter is not accepted as controlling, there is no reason why 100 is the necessary figure for a senior security holder to receive. It may be more or it may be less. *But, in this case, after consideration of all factors involved, I conclude that $100 would be fair and equitable, but that the payment of premiums would not be fair and equitable*"[130] (R. 288a, n. 2). (Italics ours.)

Likewise, the court below recognized the error of the District Court's determination in the following statement:

"* * * it [District Court] cannot value the securities, find equitable equivalents therefor and substitute its own estimates for those of the Commission requiring the plan as amended by it to be carried out" (R. 39).

Although the Central-Illinois group may deny that the District Court made a specific determination of $100 per share, the reality of the District Court's action cannot be concealed by the findings prepared by Central-Illinois counsel (R. 377a, 385a). Conse-

[130] Central-Illinois counsel chides the Commission for its use of the so-called "talismanic phrase"—"upon full consideration of the entire record", which is the Commission's conclusory statement following a full presentation of its reasoning, but finds no fault with the similar expression which appears in the quotation above from the District Court's opinion and frequently in its own Brief.

quently, the District Court, to use the language of Central-Illinois, "was intruding upon the Commission's legitimate function under the Act".[131] Such error would require remand.[132]

The Central-Illinois group also suggests[133] that the District Court should have the power upon examining the record to determine "the outer limits of permissible Commission action under the 'fair and equitable' standard". When this "outer limits" doctrine as submitted, is analyzed, it simply means that the District Court *may reduce* but not increase, the amounts awarded by the Commission, under the "fair and equitable" standard. This is, of course, grotesque. It further means that the District Court decision is final where the amount awarded by the Commission is reduced, and the Commission becomes a body of little, if any, consequence.

Central-Illinois also urges in the instant case there is no function left for the Commission "except formally to approve payment of 100 to the preferred". This clearly makes the Commission a rubber stamp and nothing else. Congress never intended any such result.

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131 Central-Illinois Brief, p. 155.

132 We have assumed *arguendo* an erroneous valuation by the Commission, but have urged, of course, the correctness of the Commission's decision in its performance of the valuation function.

133 Central-Illinois Brief, p. 157.

Conclusion.

For the reasons advanced herein and in the Brief previously submitted, the judgment of the court below should be reversed, with appropriate direction to the District Court to enforce the plan as approved by the Commission insofar as it provides for the payment to the preferred stockholders of amounts equal to the respective redemption prices of their stock (less the sum already received plus adequate recompense for the delay in payment). If this Court concludes, however, that the Commission has erred in the valuation process, this case should be remanded to the Commission for reconsideration, in accordance with the instructions of this Court.

Respectfully submitted,

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